IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON EXPORT OPPORTUNITIES AND SPECIAL SMALL BUSINESS PROBLEMS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

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IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT

WEDNESDAY, APRIL 16, 1986

House of Representatives,
Subcommittee on Export Opportunities
and Special Small Business Problems,
Committee on Small Business,
Washington, DC.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2359-A, Rayburn House Office Building, Hon. Ike Skelton (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN SKELTON

Mr. Skelton. We will call the meeting to order.

First, let me thank you for joining us today, and let me also say that we regret the inconvenience that the delay has caused those witnesses who were scheduled to testify yesterday. I hope you understand why we did so, because of the funeral of our colleague on this committee, Joe Addabbo.

This is the first in a series of hearings that this subcommittee will have on the implementation of the Regulatory Flexibility Act. While there may be more glamorous issues over which the Small Business Committee has jurisdiction, none is more important to the average small businessman and woman than this issue.

Loan programs and counseling services certainly have their place, but the reduction of Government restrictions and regulations and redtape is the most help to the small businessman and woman today.

The Regulatory Flexibility Act was designed to accomplish this goal by forcing rulemaking Federal agencies to analyze the impact of their actions on small entities, such as small business. If that impact will be substantial then the burden is on the Government to justify the need for the regulations to solicit meaningful comments from the business community about the proposal and, finally, to explore ways to lessen that burden.

The act has been in operation for 5 years now, and a significant addition has been made to the scope of the law. The most significant is the passage of the Small Business and Federal Procurement Competition Act in 1984 which clearly applies the Regulatory Flexibility Act to procurement regulations.

Congress is considering additional proposals that would clarify the act and would apply to all rulemaking done by the IRS under all circumstances. Finally, we are interested in how the act is being enforced and the feedback about the effect of the law.

Now, with that in mind, we will continue the work that was started a few years ago by my colleague from Florida, the gentleman sitting next to me, Andy Ireland, and proceed with active oversight of the implementation of this act.

This subcommittee takes the enforcement of full compliance with this law quite seriously, and I hope that we will see that we are moving in the right direction.

Our first witness is Mr. Frank Swain, chief counsel for advocacy of the Small Business Administration, who is charged with the responsibility of enforcing and monitoring compliance with the act.

I now ask Mr. Ireland if he has opening comments.

OPENING STATEMENT OF HON. ANDY IRELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. **Ireland**. Thank you, Mr. Chairman.

I think you have very clearly outlined the reason for this act. It was my pleasure to initiate this legislation, and to participate in its oversight since then.

You are indeed correct that this is the cornerstone of helping small business cope with the excessive regulation of the Federal Government.

The question that we ask in these hearings is, "Is the law working?" As you have pointed out, this is the first set of comprehensive hearings that have been held for some time. Our first hearings on oversight showed that many of the agencies were hampered by a lack of understanding of the intent of the law.

I hope these hearings will show that things have changed. If they have not changed, perhaps it is time for some rather strong legislation because, indeed, any logical assessment would say that the bureaucracy should have had time to figure out how to make this law work.

I look forward to the testimony and working with you. Thank you.

Mr. **Skelton**. Thank you.

Before we ask our first witness to testify, I might add that we are doing 2 days of hearings in 1 day, and I must leave around 10:45 a.m. because of my chairmanship with another group. However, we will continue on past that with someone else chairing the hearing. I do wish you and your colleagues will summarize your testimony because we wish to complete this 2 days of hearings in 1 and with your assistance, we can do that. Your complete statement will be made part of the record.

Mr. Swain.

Mr. **Swain**. Mr. Chairman, thank you very much.

Because of your efficiency in pulling it all together in 1 day, I would ask that my statement be submitted for the record, and I will attempt to summarize what we believe are the key points.

Mr. **Skelton**. Without objection, we will welcome that.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. Swain. First of all, I would like to thank the subcommittee for the interest in taking a look at the impact of the Regulatory Flexibility Act. As the chief counsel for advocacy at the Small Business Administration, the statute requires me to monitor the progress of the act, and it has been in that context that we have attempted to participate as much as we can in a variety of rulemakings, at many different agencies, which have significant impacts on small firms.

Over the last 4 years, our office has filed substantive, formal comments for the record on probably 45 to 50 rules per year. There is almost no agency in the Federal Government that does not routinely take actions, which, in the goal of meeting their mandate, whether it is defending the country or protecting the environment or the workplace or whatever, have a spillover impact on the small business.

Of course, it is the act which requires those agencies in pursuing their normal statutory or program mandate, take a look at what the impact of their actions is on small business.

I would say that, generally speaking, the law has been working well. The goal of the legislation is to suggest to agencies that they might actually make different rules for smaller firms. That has, in fact, been accomplished in several cases. Obviously, that is not possible in every case. However, even where an agency cannot make a different or more flexible regulation for small firms, it is required to do an analysis of the impact that its regulation will have on small firms, so that both the agency and the interested public can see whether there might be less burdensome or more flexible alternatives available.

This morning, our statement focuses on five agencies which I think present differing characteristics, partially because of their statutory and programatic mandates, and partially because of their history of rulemaking, in general.

I would like to begin by mentioning the Environmental Protection Administration. I think the EPA has had a busy history over the last dozen or so years with a lot of rulemaking, and in many ways, we would regard the EPA as a model agency in utilizing the Regulatory Flexibility Act.

That is not to say that we or that members of the small business community agree or endorse absolutely every single EPA final regulatory decision. There are still a lot of areas where we think that specific changes could be made to specific rules, but, nonetheless, we have had a very positive working relationship with the EPA. I think they have made the law work the way it should.

A couple of things are key. First of all, they do not attempt to avoid the fact that most of the rules that they issue have a big impact on small firms. There are still many agencies that do a lot of rulemaking that have impact on small firms, who would like to wish it away, and they, in fact, attempt to do that by certifying that their rules have no impact on small firms.

EPA does not generally certify their regulations. They accept the fact that many of their regulations have a significant impact.

Second, they accept the fact that they do not know, immediately, everything in the world about what the impact will be. They take some time and spend some money and hire some contractors to find out what the small business impact is, and they will accept the help and data from other organizations, including our office, in attempting to do that.

The sum and substance is, then, that in the few key rulemakings, such as the current rulemaking on effluent guidelines, that is guidelines for the level of pollution discharge in water, we have had some very significant regulatory reforms that help small business. EPA has made different rules for small business and, in a couple of cases, outright exemptions have occurred for small plants that would discharge only a very small amount into the water. And, yet, EPA, I think, feels perfectly confident that these differing rules are absolutely consistent with the very tough statutory standards that Congress has imposed in the various environmental hazardous discharge statutes.

So, we feel that the legislation is working well at EPA. We feel that we have a very cooperative relationship. There are many times that we agree to disagree, but, nonetheless, they generally have an open ear to the small business concerns. They actually have a small business ombudsman, who works with the regulatory office to make sure that small business concerns are considered properly.

There are other agencies highlighted in our report which we are releasing this morning. I would like to mention a couple of them at this point. The witnesses for the agencies themselves will obviously get into these issues in depth.

Your opening statement mentioned that this is the first hearing that has been held since procurement rulemaking has been subjected to notice and comment rulemaking procedures under a law that was passed last year. We have a beginning relationship with the Department of Defense in attempting to make sure that, as they issue their procurement rules, they do so with the maximum amount of knowledge of the impact those rules have on small firms.

I think that it has been slow going. I think that the Department has a very good record of buying from small firms, but, quite honestly, they do not have a long tradition of publicly making the rules that control buying activities.

Many times in the past, the decisions have been made, the final rule has been published, and there has been little or no period during which the public could comment. So, I think that the Department has to work hard to open the rulemaking process through the FAR Council to make sure that they take cognizance that almost anything they do in procurement rulemaking is going to have a significant impact on small firms attempting to sell to the Department of Defense. They have to do their best to assess what the level of that impact is, and specifically look at how a rule or a new procedure might be improved before it is put into effect.

A statement in our report cites several instances in which some key rulemakings may or may not have been right decisions, but, frankly, we do not know because the Department has not really done any sort of impact analysis of those rules on small firms. For example, the report comments on the rule on technical data rights, rules relating to progress payment on contractors, and others.

I think it is particularly important that the Department work hard on its agenda of what rules it will be issuing in the next 6 months or in the next year. This agenda will give notice to all parties concerned, including our office, of what is anticipated so that we might spend time trying to help them come up with some data that might be useful in their analyses.

Our statement also mentions the Internal Revenue Service, which we have reported on to this committee in the past. Generally speaking, as the committee is aware——

Mr. SKELTON. Let me interrupt you right at that point.

We have the Commissioner of the IRS coming in, hopefully, at a specific time, and I wish to tell our witnesses that because he is able to come at a specific time, we are going to accomodate him and put him on so he can get off and go about other things.

As you know, this is the day after tax returns are due, and it is a big day for him. He is out there counting checks, I think.

Thank you.

Mr. SWAIN. Thank you, Mr. Chairman.

Always happy to accomodate the Commissioner. I attempted to do that last night myself with my tax return.

The Internal Revenue Service basically does most of their rulemaking under procedures that traditionally have labeled rulemakings as interpretative rather than legislative. That is, they do not do very much notice and constant rulemaking and, therefore, they say that most of what they do does not have to be analyzed under the Regulatory Flexibility Act.

I would suggest that that is a distinction that many times is arbitrary. They should do that analysis anyway, and if they feel that they need some legal backing to do that, I am sure that the Congress can provide it.

But even in those legislative rulemakings, which are clearly notice and comment rulemakings subject to the Regulatory Flexibility Act analysis requirements, they still have no background or tradition at all of doing the analyses.

We, specifically, cite in our testimony one instance of great concern to us, the so-called magnetic media rule, which requires businesses to report electronically payroll information. In that case, the IRS issued a clearly legislative rule requiring regulatory flexibility analysis. However they opted out of doing an analysis by certifying that the rule had no impact on small firms. We disagreed formally on the record, and our letters are available citing the details. In this case, Congress, actually in the TEFRA statute, said to the IRS, you shall do an economic analysis of the impact of this change on small business.

Despite this mandate we do not think that the IRS did any sort of adequate economic analysis.

The IRS—there is no agency in the Government that has a bigger impact on more small businesses—should be more committed to taking a look at the impact of its rules on small firms. We hope that we can work with the IRS to isolate some of the rulemakings that are particularly important to small firms and, frankly, have them do a better job in analyzing the impact of their rules.

The final issue that we focus on this morning—our statement does include comments regarding the Federal Communications Commission because I am aware that the committee is attempting to schedule hearings later on—is our long and quite honestly, checkered history with the U.S. Department of Agriculture, specifically the Agricultural Marketing Service.

Mr. **Skelton**. You are not by yourself. Those of us that represent rural areas have the same kind of checkered history with them.

I could not help that. Go ahead.

Mr. **Swain**. As the chairman and Mr. Ireland are well aware, the USDA is a large agency that does many different things, implements many different programs, and in several of their programs, they have done some analyses in some key areas.

But our involvement with them has been particularly with the Agricultural Marketing Service, which administers a series of marketing orders for various commodities, under the Agricultural Marketing Agreements Act, which was passed about 40 years ago.

The nub of the problem is this: They do not believe or they do not want to do regulatory flexibility analyses of agricultural marketing orders. I am not an expert on agricultural marketing orders. I do not know whether they are good, bad, or indifferent in any given case. But from the small business perspective, from the perspective of the people that complain to us about them, we have no way of finding out because USDA has, frankly, done no analyses of agricultural marketing orders.

We have been particularly involved in marketing orders in the citrus industry and specifically are concerned with the aspects of the marketing orders that represent, in effect, Federal regulations of prices and amounts of commodities that can be sold. These are, we think, obviously severe regulations for small firms, and the AMS ought to take very seriously the requirement under the Regulatory Flexibility Act, to do analyses of what their rules will do to small firms.

Mr. **Skelton**. Right there. Have you brought lawsuits backing up that or related issues with the Agricultural Department?

Mr. **Swain**. Well, we do not have the authority to bring a lawsuit per se, Mr. Chairman, but we have attempted——

Mr. **Skelton**. How does the Justice Department——

Mr. **Swain**. We have intervened. We have sought to intervene in a Federal district court action in Pennsylvania involving the extension of new milk marketing orders into 23 previously unregulated counties.

Our intent is not to stop the regulation, maybe it is the proper thing to do.

Mr. **Skelton**. How does the Justice Department react?

Mr. **Swain**. The Justice Department has—is questioning our intervention since they are, through the U.S. attorney, defending the Agriculture Department. They are concerned that it may appear that there is a split within the executive branch on what is going on here.

Frankly, we hope to resolve the issue by having the Agricultural Department do some regulatory flexibility analyses in that case.

Mr. **Ireland**. Mr. Chairman? You said that under the act, you could not file a lawsuit. That is not totally correct, is it?

Mr. SWAIN. Well, under section 611 of the act, the chief counsel can be heard as an amicus curiae. When someone else files a lawsuit, we have the right to file under the act as a friend of the court to advise the court of our opinion on the subject.

But if we tell an agency that we think the rules would be better some other way, and they do not issue it that way, we have no right to enforce our position. Unlike, say, the Office of Management and Budget, where an agency actually has to clear their regulations. If OMB does not like the rule, they can stop it from being issued.

We only have the power to advise at the administrative level and to advise the court at the judicial level.

Mr. IRELAND. Thank you.

Mr. SKELTON. Thank you.

Anything else?

Mr. SWAIN. Well, just to sum up, Mr. Chairman, I hope that I have not dwelled too much on where I feel that we need more progress.

The Regulatory Flexibility Act is a very important law for small business. It has helped a lot of small firms by helping agencies in several cases to make better rules. We think that those agencies where there is more work to be done will consider the examples we have raised here today. Hopefully, if we were to come back here some time from now, we could report that we are all making progress together to make better rules for small firms.

Mr. SKELTON. We could spend all morning visiting with you, but because we have other witnesses, we just hope you will be on call should we need you to come back. Thank you so much for the excellent job you do, Mr. Swain.

Mr. SWAIN. Thank you.

[Mr. Swain's prepared statement follows:]

PREPARED STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. Chairman:

Almost six years ago, Congress required every Federal rulemaking agency to act differently in relation to small business, to consider less burdensome regulatory approaches for small firms or to avoid regulating in the first place. Congress recognized that the most dynamic sector of our economy -- small business -- was often crippled unfairly by the weight of Federal regulation and paperwork.

I can report to you today that the Regulatory Flexibility Act has resulted in more informed and flexible small business regulation. Enlightened by their analyses of small business impacts and the views of small business owners, Federal regulators have on many occasions decided to forego or reduce the impact of regulations.

The annual report which I am releasing today documents the regulatory activities of several other agencies, as well as ours. I am, however, also reporting that there are still problem areas. Since this subcommittee reviewed the compliance of the Department of Defense and the Internal Revenue Service in 1982 there has been some, but inadequate, progress. A few other agencies, such as the Department of Agriculture, have virtually ignored the Act, missing opportunities to move forward on regulatory reforms that we all believe are appropriate.

This morning I would like to report on some of the RFA's successes, explore problem areas and report on the activities of my office to monitor and participate in regulatory activities affecting small business.

THE FIRST FIVE YEARS OF REGULATORY FLEXIBILITY

The fundamental purpose of the Regulatory Flexibility Act is to ensure that Federal regulation is imposed on small entities only to the degree necessary to meet the goals of substantive legislation. The primary tools for achieving this result are the analysis and public discussion requirements of the RFA. The RFA specifically places responsibility on agencies, not small businesses, to gather and analyze relevant data. Federal agencies have had steadily improving, but mixed, success in dealing with regulations as they affect small business. Since the passage of the RFA, there has been a heightened awareness of the need to analyze separately the impact of regulations on small businesses.

As our annual reports to Congress on implementation of the RFA show, our practical experience during the past five years bears this out. After an initial period of concentration on the procedural aspects of Regulatory Flexibility Act compliance, Advocacy has now reached its stride in substantive involvement in critical agency rulemakings.

At first, Advocacy focused its efforts on encouraging agencies to adopt internal procedures for complying with the substantive requirements of the RFA. During that time, our involvement stressed an educational approach to inform agencies of their responsibilities under the Act. These efforts included establishment of a detailed regulatory monitoring process which permitted Advocacy to target those regulatory initiatives which were most important to small business. In addition, we demonstrated the usefulness of the Small Business Data Base for agencies in their performance of regulatory flexibility analyses.

More recently, Advocacy has been able to concentrate its resources on particular regulatory concerns of small business. These include environmental regulations, significant procurement rules and policies, tax regulations, programs affecting small business access to capital markets, pension plan initiatives, and agricultural marketing order policies. While agency compliance with the substantive requirements of the RFA has not been consistent, the RFA has clearly proven its value in a number of areas of small business concern. The efficacy of the RFA in this regard is complemented by the rulemaking notification and economic analysis requirements of Executive Orders 12291 and 12498, which are administered by the Office of Management and Budget. These are all parts of the Federal Government's regulatory management process which encourages open and planned rulemakings.

One example of an agency's reliance on economic analyses in drafting rules is the Environmental Protection Agency (EPA). Because of EPA's role in regulating all businesses in relation to the environment and the complex technical data and requirements underlying EPA rules, the targeting of small business impacts has become an integral part of EPA rulemaking. EPA's adoption of tiered standards for small businesses in the 1970s provided a model for the approach of the Regulatory Flexibility Act in 1980. EPA is continuing its important role as a lead agency in the implementation of the RFA.

The imposition of effluent guideline regulations to control pollution from industrial facilities into streams or sewer systems is an example of how the RFA helps agencies perform their missions. In these rulemakings, the application of uniform regulation to small businesses would have resulted in regulatory overkill. Without recognition of the differences between the pollution discharges of small and large businesses, small firms with de minimis discharges would be required to purchase expensive waste water treatment equipment with no noticeable beneficial impact on the environment. A proper regulatory flexibility analysis assesses not only the benefits to the environment from the regulation as a whole, but also compares the benefits derived from regulating small and large businesses. Only in this manner could EPA identify areas of unnecessary regulation.

In the foundry rule, for example, issued on October 30, 1985, EPA examined the discharge reductions for small and large plants and was able to make an informed judgment on the environmental effects. Based on information provided by Advocacy from our Small Business Data Base, EPA revised its initial estimate of the economic impacts on small plants and adopted two small business exemptions, and one industry-wide exemption, based on the revised small business analysis.

The Regulatory Flexibility Act will play an important role in the upcoming hazardous waste rulemakings, particularly those involving used oil, hazardous waste tanks, and underground storage tanks. It already has sensitized EPA policymakers to the dramatic impact of the cumulative burden of these regulations on small business. Advocacy issued a report on this issue on February 11, 1986, accompanying our comments on used oil. This report has received widespread attention, and, if its findings are adopted by EPA, will allow for less onerous regulation on small businesses.

NEW OPPORTUNITIES FOR REGULATORY FLEXIBILITY

Significant strides have been made by the Office of Advocacy, Federal regulatory agencies, and the small business community to promote small business interests. However, new opportunities for regulatory reform continue to present themselves. As the following examples demonstrate, regulatory flexibility is an evolving and dynamic concept which can serve the twin goals of devising the most efficient regulatory measures while at the same time minimizing the adverse economic impact on small business. However, the success of the RFA process depends in large part on the willingness of Federal agencies to make effective use of its tools. In some cases, this has not happened.

Significant Procurement Regulations and Policies

The Federal Government spent over $183 billion for the acquisition of goods and services in Fiscal Year 1984. Of this amount, small businesses received $32.5 billion, or 17.7 percent of total prime contract dollars. The myriad procurement laws, regulations, forms and policies governing the award and administration of these contracts are of obvious importance to small firms seeking or already holding Federal contracts. Procurement regulations and policies directly affect the small business share of Federal contract opportunities.

Prior to 1984, procurement regulation decisions were rarely made publicly because they were not subject to the notice and comment rulemaking procedures of the Administrative Procedure Act. In 1984, Congress enacted P.L. 98-577, the "Small

Business and Federal Procurement Competition Enhancement Act of 1984," which made procurement regulations subject to the RFA. P.L. 98-577's requirement that "significant" proposed procurement rules be published for public comments prior to taking effect is the "other law" triggering applicability of the RFA to these rules. (See Section 601 of the RFA). Thus, for the first time small business government contractors, trade associations, and the affected public will be entitled to examine and comment on significant procurement regulations before they are final.[1]

The passage of P.L. 98-577 was prompted by the failure of Federal agencies to follow standard rulemaking procedures for procurement-related rules. For example, DOD in 1983, without prior notice or an opportunity for the public to comment,changed their procurement rule to exempt all small purchase buys from public bid posting requirements. Suddenly, small businesses which relied on this relatively simple method of obtaining notice of small buy opportunities, had their ability to bid on these buys radically altered. This change was imposed with no public analysis of whether Federal procurement practices would be improved by its adoption.

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[1] The legislative history of P.L. 98-577 makes it clear that the notice and comment requirements were instituted for procurement rules because Federal agencies did not voluntarily comply with similar procedures which were put forth in OFPP Policy Letter 83-2. This Policy Letter did not have the force and effect of law and Congress sought to remedy this by codifying virtually the same requirements in Section 302 of P.L. 98-577.

Another example is DOD's issuance of its FAR supplement in 1984 with only a notice concerning ordering procedures. DOD subsequently published its complete FAR supplement in the Federal Register and requested comments -- less than one week before its effective date. Although government contractors and other interested parties had participated in the development of the amended regulatory scheme, the formal comment period was far too short to elicit meaningful responses from other interested members of the public.

Section 302 of P.L. 98-577, by changing the requirements for notice and comment for procurement rules and placing them within the purview of the RFA, was adopted to address these kinds of situations.

The Office of Advocacy focused its efforts to obtain RFA compliance on the Civilian Agency Acquisition Council (CAAC) and the Defense Acquisition Regulatory Council (DAR Council). These bodies are jointly responsible for preparing, issuing, and maintaining the Federal Acquisition Regulation (FAR), the single body of procurement regulation which applies to Federal executive agencies. In January 1985, the two councils issued an "interim rule" to implement the P.L. 98-577 requirement to publicize proposed procurement rules. However, these procedural guidelines did not address the role of the RFA in the procurement rulemaking context. The Chief Counsel responded with a detailed letter explaining the applicability of the RFA to significant proposed procurement regulations, and how RFA requirements can be fulfilled. In personal meetings with the DAR Council and the CAAC, Advocacy staff explained RFA requirements and answered questions about the RFA's applicability to the procurement rulemaking process.

Overall compliance with the RFA improved somewhat following these initial efforts. However, a number of serious problem areas remain. These include: (1) the propensity to publish rules with immediate effectiveness as "interim rules" is inconsistent with the P.L. 98-577 requirement that such rules be published as proposed rules before taking effect; (2) in many cases, proposed rules have no certification, or are certified as having no significant impact without a statement of rationale; and (3) where an IRFA is performed, there is often insufficient analysis of the proposed rule's effect on small business contractors. Our annual report specifically addresses rulemakings in which these problems occurred, e.g., the proposals to lower progress payments and to define prequalification procedures. Two additional proposed procurement rulemakings should be noted.

In February 1986, the Defense Department published a proposed rule concerning the limitation of progress payments for undefinitized contracts. (Those contracts in which price or terms are not definite at the time the contract is signed.) The Director of the Defense Acquisition Regulatory Council (DAR Council) forwarded an Initial Regulatory Flexibility Analysis (IRFA) for this rule for our review.

Although the Defense Department does not maintain data which would enable them to do a precise and comprehensive IRFA (they do not have the number of small businesses having undefinitized defense contracts to which the 80 percent limitation applies), they sought to minimize the effect of the rule on small entities by limiting the applicability of the rule to certain contracts and contract actions more likely to be held by large businesses.

All the problems with procurement rulemaking, however, have not been resolved. In a new notice of proposed rulemaking, the DAR Council and the CAAC proposed to shift the burden of proof on the issue of reasonableness of contract costs from the government to the contractor, abolishing the historic presumption of reasonableness which attaches to incurred costs. The notice states that the proposed rule is considered necessary to ensure that only reasonable costs are paid under government contracts. A certification of no significant impact on small business was published with the rule. This certification completely ignores the vast potential for additional documentation which contracting officials may demand of small businesses.

We are hopeful that procurement rulemaking will improve and intend to continue working with the two councils closely until full compliance is attained. The Office of Advocacy is always available for assistance and advice to guide the procurement rulemakers toward this goal.

The Internal Revenue Service and Regulatory Flexibility

The Regulatory Flexibility Act applies to all rules promulgated pursuant to Section 553 of the Administrative Procedure Act. The APA does contain some exemptions, one of which is for interpretive rules. An interpretive rule is one which is intended only to translate specific statutory requirements into regulatory language, and is one in which Congress has not delegated legislative-type authority to the agency. One of the rationales for exempting interpretive rules from "notice and comment" rulemaking is that, although notice may be good for the public to have, the extensive solicitation of comments or suggestions is futile because the agency is only following the specifics of the legislation and has little or no discretion to change the rule. The Internal Revenue Service (IRS) defines many of its regulatory actions in this category.

Although the IRS often publishes its proposed rules for comment, it does not follow the analysis provisions of the RFA. In some instances both the public and the agency would benefit from the performamce of regulatory analyses since they would lead to better rulemaking, both in terms of better crafted rules as well as increased public acceptance of the proposals as finally adopted. One such rule where regulatory analysis would have benefited the IRS and the public is the so-called "auto log" rule.

The original auto log regulations implemented 1984 changes in the tax code which required strict "contemporaneous" recordkeeping and other procedures to document the business use of vehicles in order to qualify for an investment tax credit and for business expense and depreciation deductions. Although the IRS was not bound by the RFA to perform regulatory analysis in this instance, had it done so many problems may have been anticipated and corrected before the regulations were published. The discussion of possible alternatives required by the RFA would have assisted the public in understanding the requirements of the law as well as any limitations imposed by statute on the IRS' flexibility.

Although revised regulations published in November 1985 represent a significant improvement on behalf of small business, a great deal of confusion has been created that will take some time to straighten out. The "burden" imposed on the

IRS to assess the impact of its regulations before they are proposed is far outweighed by the chaos and delay resulting from the failure to carefully examine options.

On September 18, 1985, the Internal Revenue Service (IRS) issued proposed rules which require certain categories of information returns to be filed by employers on magnetic media, i.e. computer tapes or disks. This rule is clearly legislative in nature and subject to the Regulatory Flexibility Act. Magnetic media reporting of returns would be required if, for the calendar year 1986, 500 or more "returns of information" are to be filed. For calendar years 1987 and later the volume requirement is to be lowered to 250.

In prescribing these regulations, the IRS was also statutorily charged with considering the ability of taxpayers to comply at a "reasonable cost" with the filing requirements. However, no cost estimate or other economic impact analysis was performed. Furthermore, the IRS erroneously certified the rule as having no small business impact. The Office of Advocacy has strongly objected both to the RFA certification and to IRS' failure to comply with Congress' specific directive that any such rule take cost impact into account.

There are at least two reasons the IRS proposal would significantly affect a substantial number of small businesses: (1) the extent of coverage of the rule of all workers, full and part-time, and (2) the start-up expense to noncomputerized small firms. Neither issue was analyzed by the IRS.

Upon publication of the final rule on March 25, 1986, the IRS reiterated its certification of no small business impact and rejected Advocacy's contention that a regulatory flexibility analysis was required. Rather than examine whether or not the rule would place disproportionate regulatory burdens on small business, the final rule merely provides that IRS will grant a waiver of the magnetic media filing requirement if particular businesses can demonstrate special hardship.

The Office of Advocacy has repeatedly urged the IRS to put aside the often arbitrary distinction between interpretive and legislative rules and utilize the analytical procedures of the RFA to provide a solid foundation for its rulemakings which affect hundreds of thousands of small businesses. This would not only strengthen the content of the rules, but also by broadening public participation, strengthen the support for those regulations. Even in situations where the underlying statute limits the agency's discretion in formulating a rule, and may not permit adoption of otherwise viable alternatives identified in a regulatory flexibility analysis, the analysis would be particularly valuable to Congress and the public in deciding whether to permit the agency to adopt those alternatives in the future. The IRS has failed to embrace these opportunities to apply regulatory flexibility procedures in a constructive manner.

Agricultural Marketing Orders

Marketing orders issued by the Department of Agriculture impose a variety of controls in the marketing of certain fruits, vegetables and "specialty crops" such as hops and spearmint oil. We share the USDA's and the Administration's goal to increase the role of market forces and reduce the government's complex regulation in the agricultural sector. Among the items now regulated are 33 commodities valued at over $5 billion annually, which include over half the fruits and nuts and approximately 15 percent of the vegetables produced in the United States. The procedures for establishment and operation of marketing orders are governed by the Agricultural Marketing Agreement Act of 1937 (AMAA). Under the AMAA, the Secretary of Agriculture may issue a rule establishing an "order" and defining its powers and procedures. The order must then be ratified by a referendum of producers. Thereafter, an "administrative committee" representing primarily producer interests periodically develops implementing regulations which, after review by the Agricultural Marketing Service (AMS) and approval by the Secretary of Agriculture, are published and take legal effect over the entire industry.

Many controls proposed by the committees and adopted by the Secretary are primarily technical and have aroused little controversy. Others, however, severely restrict the flow of crops to market, curtail supply, drive up prices, and prevent small businesses -- which constitute the majority of growers and handlers -- from independently marketing or processing their crops. In the case of lemons, for example, small producers have at times been forced to divert as much as 80 percent of their crops to secondary or waste uses.

To comply with the RFA, analyses should be conducted at the time orders are established or amended and when annual marketing plans for imposition of controls are considered. This is the point at which the regulatory impact will be felt by producers and alternatives should be analyzed. Currently the AMS does no RFA analysis of new or amended marketing orders.

Citrus marketing orders are implemented through general "marketing policies" proposed by the Citrus Administrative Committees and approved by the Secretary. AMS claims that these annual "marketing policies" are not rules, although the weekly actions to regulate shipments are planned in detail in these "policies." When a weekly volume regulation is actually issued, it is as a final rule. The AMS's procedural sleight of hand means that no economic analysis is ever performed by the AMS or shared with the public.

The AMS has advanced several arguments to justify its non-compliance with the RFA: 1) since these rules are made under formal rulemaking procedures there is no need to perform an IRFA; 2) because the AMAA requires that a uniform rule be adopted for all handlers and growers no alternatives for reducing the burdens on small businesses can exist; 3) that because marketing orders are self-imposed regulations which are voted on by the regulated industry no disproportionate impact can result and therefore no IRFA is required; and 4) that the benefits of the orders outweigh the burdens of the regulation and therefore no IRFA is necessary.

These arguments are not supportable under the RFA, AMAA, or any other applicable legal or regulatory concept. First, the RFA makes no exception for rules promulgated under formal rulemaking procedures since the requirements of the RFA are triggered whenever an agency is required "to publish notice of proposed rulemaking for any proposed rule" (5 U.S.C. §603(a)). Second, the RFA is concerned with not only tiering regulations for small businesses, but also with choosing the least burdensome alternative from a range of possible alternatives. Third, although these regulations are voted on by the growers and handlers, the lack of an RFA analysis means that these small businesses will not know whether or not they are voting for the best available alternative. Finally, the AMS's assertion that the benefits of a proposed regulation outweigh the burdens cannot be demonstrated without a realistic economic analysis of the proposal and its alternatives.

Providing the public with an adequate assessment of available regulatory options is at the heart of the Regulatory Flexibility Act's requirements. While some of the larger industry participants, which have disproportionate representation on the administrative committees, may have all the necessary data to evaluate the impacts of the regulations the majority of smaller entities do not. Even in situations where an administrative committee in fact proposes the most effective and least burdensome marketing controls, the failure to perform a regulatory flexibility analysis may result in a lack of understanding of the need for the proposed controls.

Furthermore, the USDA presently has no criteria to measure marketing order performance and no system to evaluate whether marketing orders meet the purposes of the AMAA, to determine whether particular marketing order changes are appropriate, or to justify changes in overall marketing order policy.

A 1985 GAO report cited this lack of criteria and analysis as the major area for marketing order reform. "Such evaluations would be useful in clarifying the impact of marketing orders so that all parties involved could more appropriately judge the merits and shortcomings of marketing orders." (GAO/RCEP-85-57, p. 55). Clearly, the regulatory flexibility analysis process would provide just such a tool and would be particularly useful in clarifying the impact of marketing orders so that all parties involved could more appropriately judge their merits and shortcomings.

The lack of proper USDA analysis of marketing orders prompted us to seek to participate as an amicus curiae in the United States District Court for the Eastern District of Pennsylvania in an action challenging the reasonableness of a proposal to extend milk marketing orders into 20 counties in Pennsylvania. The plaintiffs are alleging that the USDA is proposing to amend marketing orders but failed to include in the record the detailed economic analysis necessary for proper rulemaking. The purpose of our request to intervene in this case is to further illustrate to the USDA that the regulatory analysis requirements of the Regulatory Flexibility Act are an established component of regulatory procedure and cannot be ignored.

The USDA is currently conducting a rulemaking on a proposed egg marketing order. This rulemaking will once again give the USDA an opportunity to comply with the dictates of the RFA. The egg marketing order will have two major components, a research and promotion program and a hen eradication program, both financed by assessments on egg handlers. Public hearings have been held in a number of locations on the proposed order. In addition to public testimony, the USDA has entered a significant amount of economic data into the rulemaking record. Consequently, the USDA has all the components it needs to conduct a regulatory flexibility analysis of the proposed rule. This analysis should be published simultaneously with the Secretary's recommended decision on the egg marketing order proposal.

Federal Communication Commission Rulemakings

The Federal Communications Commission has avoided regulatory flexibility analyses by attempting to exclude groups of small businesses from RFA coverage. As an example, the Commission has determined that small telephone companies are dominant entities in their areas and, as such, not small businesses requiring the analysis provisions of the RFA.

In a variation to this approach, the Commission certified a rulemaking involving satellite license allocations as having no affect on small business since the proposed rule would eliminate all small business license applicants. The certification came despite the existence of small business license contenders who, under the proposed rule, would have to demonstrate the ready availability of $300 million in cash or credit in order to keep their applications current. The obvious problem created for small applicants by the proposed rule was dismissed by certifying no small business impact since, according to the Commission, by definition, no small business has $300 million. Credit or equity financing involving contingencies requiring further action or performance by the satellite licensee or by the purchasers of the satellite's transmitting capabilities (transponders) would not be permissible under the proposed rule. Since most of the smaller companies had planned to finance their ventures with revenues from the sale of satellite transponders, the proposed rule eliminated the primary means by which members of this group could finance a satellite.

The Office of Advocacy in written comments informed the Commission that the certification was improper since the Commission cannot propose a rule that would eliminate all small businesses from a given market and then certify that it will have no effect on small businesses merely because none will exist if the proposed rule becomes final. Advocacy recommended a complete reissuance of the proposal in order for the RFA deficiencies to be corrected. The FCC is presently considering its position in the matter.

In another FCC rulemaking, which had serious implications for hundreds of small resellers of WATS telephone service, the Commission neglected to undertake an RFA analysis on the grounds that the proposed rule had no direct affect on small entities. The conclusory dismissal of the RFA in a footnote to the proposal came despite an extensive discussion in the text of the NPRM acknowledging this market and detailing the reasons resellers should pay the higher charges. The proposal included a revised treatment for resellers of a special long distance service known as WATS. Under the new rule, resellers would no longer be allowed to pay the business line rate for access to the local exchange. Instead, the significantly higher carrier access charges would apply, meaning that a number of resellers would probably cease operations or, at the very least, witness a precipitous drop in profitability. Despite the fact that a number of WATS resellers are small, the FCC did not undertake a small business impact analysis as required by the Regulatory Flexibility Act. This decision was based on a prior determination that the Act was not applicable since the proposed rule would not directly affect any group that could be considered a small entity.

In written comments to the Commission, Advocacy protested this conclusion and the relegation of the RFA to a footnote. This office called upon the Commission to reissue the rule with an extensive IRFA acknowledging that the impact of the rule was not limited to local exchange carriers and that some of the most directly affected parties would be WATS resellers who would incur substantial increases in the cost of doing business. However, the final rules were announced in mid-March, with the FCC adopting the WATS resale proposal without the benefit of an RFA analysis.

Conclusion

Mr. Chairman, I wish to commend the Subcommittee for holding these hearings today, and urge more frequent meetings on this topic. Constant Congressional oversight is a very effective tool for urging agencies to comply with the RFA.

Thank you for the opportunity to present these views. I will be happy to answer any questions you may have.

Mr. SKELTON. Mr. Ireland.

Mr. IRELAND. Mr. Swain, could you explain to us how you operate? Do you still have one person in your office assigned to each agency?

Mr. SWAIN. Within our office, we have a person assigned to each of the agencies that has a major level of regulatory activity such as the agencies that we have discussed in our testimony as well as the Department of Labor, the Securities and Exchange Commission, and several other agencies. We closely monitor those agencies where they are doing a lot of work that involves economic, health, and safety, or procurement regulation. We have key people assigned to those agencies to make sure that the certifications that the agencies issued are well based or, if they are doing an analysis, that we take a look at that analysis and see what we can add to it.

So, yes; we try to pick and choose which agencies are obviously most important and most active.

Mr. IRELAND. What about the negotiated rulemaking. Does that work? Do people complain about it, or do you utilize it?

Mr. SWAIN. Well, obviously, our role is basically as a negotiator. We do not have the legal authority, nor do I think we should, of ordering an agency not to do something. We come in there as an advocate for small businesses as small business groups do, when they comment to participate in rulemaking.

And, so, obviously, if an agency follows our suggestion, it is because, hopefully, we have been able to convince them that it makes sense to make this change on behalf of small business.

All that we really ask, even if agencies disagree with us, is that they put on the record why they disagree with us, or why they do not think their rule has an impact on the small firms or why they do not think the impact is very bad. The most frustrating situation is when an agency says, regardless of what we submit, that their rule has no impact at all. I would much rather deal with an agency that says we measure the impact differently and we cannot make this change. We still have too many agencies that wish away small business impacts by certifying too quickly.

I think that the regulatory negotiation that you may be referring to has been sort of a hybrid administrative law procedure that has been pioneered, I know, by the EPA in a couple of instances. Although we have not worked directly on those cases, we see it as a very positive step.

Activity which encourages these decisions to be made with as much knowledge as possible on economics impacts is a positive step.

Mr. IRELAND. That, clearly, could shorten some of the period of time in the process if they get into those things early enough.

Mr. SWAIN. That is absolutely right. There is no reason that an agency should say we cannot comply with the Regulatory Flexibility Act because we do not have time enough to do it. The EPA is under all sorts of statutory mandates with hammer provisions, but they let us know early on when they are going to be doing something, so that we have plenty of time to work with them.

The agencies who say we only have 2 months to put a rule into effect, when, in fact, they have been thinking about it for 2 years and wait till the last minute to tell anybody else about it, present the most frustrating situation.

Mr. IRELAND. Thank you.

Mr. SKELTON. Thank you. The gentleman from North Carolina, who just came in from a marathon.

Mr. COBLE. Thank you, Mr. Chairman.

Mr. Swain, I would like you to comment on the paperwork reduction of the Regulatory Flexibility Act.

Mr. SWAIN. You would like our reaction on the interplay between the Paperwork Reduction Act and the Regulatory Flexibility Act?

Mr. COBLE. I guess what I want to know specifically, is it working?

Mr. SWAIN. We think, obviously, the Regulatory Flexibility Act is working by and large.

We think that the Paperwork Reduction Act, which, along with the various executive orders, is really a part of a group of regulatory reform procedures that have been implemented by this administration. We think all of those are very complementary to the Regulatory Flexibility Act and vice versa.

It is all intended to get some sort of central control of regulation and to open up the regulation writing process to the public. The Paperwork Reduction Act specifically, which we held hearings on a few years ago, has been great for the individual. I am sure Mr. Egger may talk about that later on, if you were to ask him about it. But, quite honestly, it has not done all that much for small business. We are concerned that the paperwork directed toward small business has not changed as much as it could have, particularly in two areas.

First, in the area of taxation, and this is a tough one, because the Congress has passed four pretty complicated tax bills in the last 5 years. The IRS is under the gun to implement new rules but, too many times, I think they find it easier to issue new paper than not.

The other area is in the area of procurement procedures, where there are a lot of calls for reform. Obviously, the problem with procurement is you want to cut down the paperwork as much as possible to encourage small companies to go out and dare to do the business with the Government. On the other hand, I am sure the people from DOD will tell you that you cannot cut it down too much because there have to be safeguards for quality products and sound financial practices.

We would like to see a happy medium which goes somewhat further in the direction of paperwork reduction, though.

Mr. COBLE. Do you think we are probably approaching that happy medium? Do you think we are at least closing in on it?

Mr. SWAIN. Well, I think, everyone in the Government realizes that the easy victories have been won. The administration has bragged, and I think accurately so, about a 15- or 25-percent reduction in paperwork.

It is going to be very tough, if at all possible, to get another 25-percent reduction in paperwork. But I still think there is a long way for a number of agencies to go, and I do not exempt the Small Business Administration from that either. There is a lot of things that we can do better in our programs, but I think that particularly in the tax area and the procurement area, paperwork reduction needs to be a very high priority.

Mr. COBLE. Thank you, Mr. Swain. Thank you, Mr. Chairman.

Mr. SKELTON. Thank you. We appreciate you being with us.

Mr. SWAIN. Thank you, Mr. Chairman.

Mr. SKELTON. As I say, stay on call.

The next gentleman, Mr. Robert Felty, vice president, Computer Dynamics, Inc., Virginia Beach, VA. Is there a gentleman with you, Mr. Felty?

Mr. FELTY. No, sir; I am by myself today.

Mr. SKELTON. Well, first, I want to apologize to you and to your colleague, Mr. Fuentes, I believe was his name.

Mr. FELTY. Yes.

Mr. SKELTON. You were kind to respond and at your own expense. You came before the committee with your thoughts on this issue, and because we had to postpone our hearing yesterday, you were unable to testify. You were kind enough to stay, and we appreciate your dedication to this.

You may proceed. I do suggest that you keep your testimony as short as possible.

TESTIMONY OF ROBERT B. FELTY, VICE PRESIDENT, COMPUTER DYNAMICS, INC., VIRGINIA BEACH, VA

Mr. FELTY. My comments, sir, are short and to the point, and it is a pleasure to be in the District of Columbia again. An extra day here is always—it is nice to come up from the field to offer testimony.

As a concerned small businessperson, I am glad that the committee is looking into how the Federal Government does business with small business. Approximately 95 percent of my company's business is with the Federal Government, and 65 percent of this volume is with the Department of Defense.

I have been in business for 6 years and specialize in computer systems engineering. Last year, we were fortunate enough to be named the Small Business of the Year for the State of Virginia in 1985.

Mr. Chairman, as a former contracting officer with NASA and the Navy and vice president of contracts for Computer Dynamics the last 4 years, I can tell you firsthand that regulations which govern the selling of items, services to the Federal Government do need to be revised and, if possible, simplified.

Government procurement practices have had a serious impact on my business. All indications are that these impacts will become worse. The Regulatory Flexibility Act has built-in procedures to lessen those burdens and impacts on my company. Our greatest hope is that these procedures can be made to work.

There are two contracting regulations which I would like, specifically, to address today. One, the reduction in customary progress payment rates is already in effect. The other, a proposed change for the historical presumption that costs actually incurred by my company in performing Government contracts are reasonable—which would be changed in favor of a requirement that the contractor must affirmatively prove to the contracting officer the reasonableness of its incurred costs—may have a significant adverse effect on us and many other small business contractors in the future.

As you know, last year, the Department of Defense lowered its progress payment rates for small businesses from 95 percent to 90 percent of those costs which we actually have incurred.

Frankly, when this happened, we did not know about it, and, consequently, we had no opportunity to comment on this change before it went into effect. In practice, the fact that we can only receive 90 percent reimbursement for our ongoing contract-related costs means that we are burdened with an additional cost of money to finance work which we have already performed for the Government.

These extra financing expenses reduce our profit margin because they are not allowable costs which can be recouped from the Government on the cost principles of the Federal Acquisition Regulations.

Had we known at the time that the Government or Defense Department had intended to lower these customary progress payment rates before making them effective, we would have had an opportunity to make specific experiences and concerns known to the procurement rulemakers.

I certainly hope that when other procurement regulation decisions are being considered, we and other concerned small business contractors are given an appropriate opportunity to comment on their potential effects.

We, are also concerned with the proposed change in the traditional rules governing the burden which a contractor must meet in demonstrating that the costs which it actually has incurred in performing a Government contract are reasonable within the meaning of the regulations.

In 1985, Congress passed a law providing that in cases where we decide to challenge a procurement cost decision in court, the burden of proof of the reasonableness of cost is shifted to us. However, last month, the agency proposed a rule which would go even further than the change made by Congress. It would now require that we meet this new burden when we are dealing with any situation where the contracting officer challenges any of our costs. We feel that this proposed rule goes further than what Congress required, and we are concerned that our already onerous administrative and paperwork burdens will be further increased.

Specifically, under the present system, we are already subject to continuous audits and document requests from various contracting officers and auditors from a number of agencies. This requires us to have at least one full-time professional CPA staff accountant constantly engaged in servicing and processing the Government's requests. There is no way that we can anticipate the extra work and documentation which would be required under the proposed rule, so we expect that it would require significantly more professional staff time.

Although we appreciate that we will have an opportunity to comment on this proposed rule, we are concerned that the proposal provided no analysis as to what impact it would have on small business.

Mr. Chairman, I have been asked on numerous occasions to speak to various small business groups encouraging them to do business with the Federal Government. That task becomes more and more difficult as potential small business contractors increasingly ask me for advice and guidance as to how to deal with all the paperwork and regulatory barriers involved.

Frankly, my overall experiences with dealing with the Government have been very positive, but not without frustrations. A cooperative and understanding approach involving both the Government procurement regulators and the small business community can have a very positive effect.

It is our hope that the Regulatory Flexibility Act will help to achieve this goal.

Thank you very much for hearing me out.

Mr. SKELTON. Mr. Ireland.

Mr. IRELAND. Thank you very much, Mr. Felty.

I certainly share your analysis. I think you are going about in the right way.

In that second example of challenging the costs, there was just no analysis provided at all by the Department of Defense on the impact on the small business?

Mr. FELTY. That is my understanding, yes.

Mr. IRELAND. And, then, on your first example, the change in progress payment costs, when did that take place? Did that take place before the new law went into effect or is that since then?

Mr. FELTY. I believe that was before.

Mr. IRELAND. Before?

Mr. FELTY. Yes, sir; that, very simply, for work that we have performed, we are going to receive a rate of return that is less.

Mr. IRELAND. I understand that.

Mr. FELTY. And that costs us money at the bank, and the banks are getting rich at our expense.

Mr. IRELAND. Well, thank you. I appreciate your staying over to be with us.

Mr. FELTY. No problem.

Mr. IRELAND. Thank you, sir.

Mr. SKELTON. The gentleman from North Carolina.

Mr. COBLE. Mr. Chairman, this might be a little irregular. I think I want to ask Mr. Swain another question—may I do that?

Mr. SKELTON. You certainly may. I told you to stay on call, Mr. Swain.

Mr. COBLE. Mr. Swain, I will call you back to the firing line.

Mr. SKELTON. Do not leave.

Mr. COBLE. Did the Department of Defense do anything under the Regulatory Flexibility Act with small business progress payment regulations?

Mr. SWAIN. Well, there are two regulations. There is one regarding completed contracts, and one regarding something called undefinatize contracts. I am not an expert in this area. So, I may have my verbiage somewhat off.

The initial completed contract proposal was initiated, I believe, before the effective date of the laws that were passed last year that would trigger the Regulatory Flexibility Act.

The other rule that Mr. Felty referred to, which is the rule shifting the presumption, you know, all of a sudden, that the contractor has to prove a lot that he did not have to prove before, was clearly a change that was made after the implementation of the Regulatory Flexibility Act, and the point that we made in our comments was not that that shifted the presumption, good or bad. Maybe it is necessary to really root out fraud, abuse, waste, the four horsemen of inspector generals or whatever we always talk about.

But, the Department made no attempt, from our perspective, in taking a look at what this actually meant in the real world of requiring a contractor, such as Mr. Felty, to come up with more paper, more justification or spend more time doing it.

In other words, there is a cost tradeoff, and if Mr. Felty had built more time into his overhead because he is going to have to do more paperwork, we are all going to end up paying for it, and that sort of analysis should have been made up front, and in our opinion, was required to be made by the act.

Mr. COBLE. Mr. Felty, I presume you concur with that.

Mr. FELTY. Yes, I do.

Mr. COBLE. Right.

Mr. FELTY. CPA's are not inexpensive, and overtime is paid, and that is a reimburseable expense under the regulation. So, it does come backwards to the Government.

Mr. COBLE. What is the current status of this rule, Mr. Swain?

Mr. SWAIN. I believe that the rule has—I am not sure. I think it is not final yet. No; it has gone out for—the comment period is closed and the Department is presumably assessing the comments, including those that were made from small firms, but it is not a final rule.

The contract, completed contract issue, has become final.

Mr. COBLE. Thank you, Mr. Swain. Thank you, Mr. Chairman.

Mr. SKELTON. Any other questions for Mr. Felty?

I have one area to touch upon. I am on the Armed Services Committee as well, and my first exposure on the Armed Services Committee was during the final months of Dick Ichord's days—the gentleman from Missouri. He chaired a special panel on the Defense Industrial Base. The conclusions were quite disturbing considering the fact that there is a shrinking pool of contractors. I hope you are hearing this, Ms. Spector, there is a shrinking pool of contractors out there that want to do business with the Department of Defense.

I am concerned, and I do wish your opinions, in talking with your colleagues and friends, associates in similar businesses, do you find an attitude of people who really refuse to do business with the Department of Defense because of the complexity and problems that they have had with it as was reflected in that earlier hearing?

Mr. FELTY. Yes, sir.

Mr. SKELTON. Would you tell us about that?

Mr. FELTY. Two particular things come to mind.

One is the paperwork involved and also in conjunction with that, being paid, prompt payment act, which is really not very prompt.

The other one is a lot of procurements now are being—instead of going out in singular effect are being combined into one big procurement. Many, many small businesses cannot go after $5 million procurements. If they were broken up to $1 million, yes.

There is a meeting on Friday between the Norfolk Naval Shipyard and the Portsmouth Chamber of Commerce Association. I am going to appear on a panel. It has to do with subcontracting. If contractors do not desire to go after a prime contract themselves, how would they go about the business of subcontracting to a prime and try to avoid a lot of the regulatory processes and paperwork, and the bad news is that the subcontractors are in the same boat as the primes.

The paperwork has to be done. They are paid when the prime is paid, and it is unfortunate it is being extended and extended.

Mr. SKELTON. As I recall, the evidence back in the 1950's and 1960's, we had a very large number of people, companies, small and large, willing to do business with the Department of Defense as opposed to today, the pool is shrinking. A good part of which is reflected from the testimony. It is just too much trouble to do business with them, and this concerns me because it has a direct effect on the defense of our Nation.

So, I will put that same question to the young lady who will be testifying shortly. Thank you so much, Mr. Felty, and I apologize to your colleague, Mr. Fuentes, for having to stand him up yesterday.

Mr. FELTY. No problem at all, sir. He had another commitment, which he could not avoid, and I am sure he would like to come up again at your convenience.

Mr. SKELTON. Thank you so much.

Mr. FELTY. Thank you.

Mr. **Skelton**. Now, the young lady we have been waiting for, the Deputy Assistant Secretary of Defense for Procurement, Department of Defense, Eleanor Spector.

Before you begin your testimony, Eleanor, do me a favor and in an imaginary wiring diagram, tell us where you fit and where the other people who work for you fit for the Defense Logistics Agency and the like, please.

Ms. **Spector**. I am sorry?

Mr. **Ireland**. Do we have time?

Ms. **Spector**. I am not that bad. With Packwood, this may all change.

Mr. **Skelton**. Wait a minute, wait a minute.

TESTIMONY OF ELEANOR SPECTOR, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROCUREMENT, DEPARTMENT OF DEFENSE

Ms. **Spector**. I am two tiers down from Secretary Weinberger. I am a Deputy Assistant Secretary reporting to him.

DLA reports——

Mr. **Skelton**. You are going to have to speak English for everybody. I understand.

Ms. **Spector**. I am sorry.

Mr. **Skelton**. I am not sure everybody in the room does. DLA is the——

Ms. **Spector**. Defense Logistics Agency.

Mr. **Skelton**. And tell them what that does in 10 words or less.

Ms. **Spector**. They have basically two functions.

One function is they are a consolidated buying activity. They buy everything from clothing and uniforms to tombstones, food, anything that all three services use. Fuel is their biggest budget item, in fact. Anything that all three services use, DLA buys.

Mr. **Skelton**. They are also in the service procurement area, too, which I think is a violation of their charter, but we will get into that someplace else.

Ms. **Spector**. Well, they do buy some things, I guess, that are service peculiar.

Mr. **Skelton**. Yes; I know.

Ms. **Spector**. By and large, they are buying things that are common to the three services.

Mr. **Skelton**. That was the original charter. Go ahead.

Ms. **Spector**. OK. Their second function is a consolidated contract administration service. Again, to a large extent. They will mostly have cognizance over contractor finance where there are many services in a plant, using that plant.

They are our largest contract administration activity, and they administer most of the contracts where there are several services in a plant. There is still service-peculiar contract administration services as well. Those are their two basic functions.

Mr. **Skelton**. All right. Anything else you want to tell us about your wiring diagram?

Ms. **Spector**. They report to us. DLA does, and the DAR Council. Now, who works for me. The group that you are probably interested in for these purposes is the DAR Council.

The DAR Council works for me. I have four other activities. I am in procurement policy; that is my job. Very limited. Almost no implementation.

Mr. SKELTON. The difference would be what you do and what the Packard Commission recommends, a procurement czar, an assistant secretary for procurement?

Ms. SPECTOR. Well, it is almost acquisition. What they are talking about, requirements—procurement is a much narrower area than acquisition, which handles what the requirements are, which I do not get into, strategies, the threat, which I do not get into.

You would start from that point and carry it right through to the actual buying. I am an adviser to the group that makes those decisions, the Defense Systems Acquisition Review Council, the DSARC, on procurement matters.

The terms have been used so interchangeably that many people are confused.

Mr. SKELTON. Now, are you familar with legislation? One bill, of which I am the principal sponsor, another which Jim Courter is the principal sponsor, deals with the Defense Logistics Agency and the various agencies in the Department of Defense.

Ms. SPECTOR. I am somewhat familiar with them.

Mr. SKELTON. Let us take the extreme. There was—it has been a push in some quarters to do away with the DLA, Defense Logistics Agency.

How would that affect——

Ms. SPECTOR. I think that would probably be a mistake. We have been under a lot of criticism for how we buy things.

Mr. SKELTON. Yes, yes; you have. I will agree.

Ms. SPECTOR. One of the main things the DLA does or should be doing in the best of all possible worlds is combining purchases of like items in a central buying activity.

We can get better pricing presumably on fuel if one agency buys all our fuel. The same thing with anything else. Clothing, uniforms, things of that nature. So, there is a very logical reason for that.

The other thing is on the contract——

Mr. SKELTON. Let me interrupt you.

There are those very high within your administration that want to do away with the DLA, and to let the services themselves buy those items, and they think they can do it cheaper and better.

Ms. SPECTOR. Of course, I am not a political appointee so, I am not going to give you a political viewpoint. I will give you a procurement viewpoint.

Mr. SKELTON. Go on.

Ms. SPECTOR. My viewpoint is that there are mistakes made in the services as well as at DLA. None of the services are clean on these misadventures in spares that we have had. I wish they were, but none are.

I am not sure that DLA's mistakes, if there have been some, are any larger than the services. I would like to give you an example of one mistake DLA was criticized on, the toilet seats.

The toilet seat for the P-3 was designed 25 years ago as a unique cover for the toilet. Well, it is a cover with a seat on it. It is custom-made by a high technology aircraft manufacturer. We buy, maybe, 12 at a time. Nobody wants to tool up to make that. So, we keep buying it from Lockheed. I cannot imagine anybody wanting to compete on it. It is just not worth it to tool up to make it.

Well, whose fault is it? Is it the DLA buyer who is buying it? Not really. Is it the service contractor who designed it initially? Is it cost effective to redesign the whole thing? Probably not, but is it DLA's fault? Not really. That is the only thing now that will fit in that area. It is the Navy who has been criticizing DLA the most vociferously.

Mr. SKELTON. I was not going to say that.

Ms. SPECTOR. The design agent—well, I am sorry. It is the design agent for the toilet seat, OK, and now they are criticizing DLA.

I cannot say it is a proud story on that item, but neither can I fully blame DLA's buyer for buying 12 replacement spares so the P-3 could fly. It is not fully DLA's fault. By and large, they do a very good job. By the way, they are the organization that gets about 98 percent competition on everything that they buy. Very high rate.

Mr. SKELTON. OK. You have about 2 minutes left in your statement.

Ms. SPECTOR. Let me whiz through it quickly and try——

Mr. SKELTON. If you would like, without objection, we will put the entire statement in the record.

Ms. SPECTOR. Please. If you would. I will not read the part about how happy I am to be here.

Mr. SKELTON. We can tell.

Ms. SPECTOR. What I would like to say, though, is we are sincerely trying to comply with the Regulatory Flexibility Act. We are trying valiantly. It is new to us. We have made some mistakes, but we really are sincerely making an effort. I have a very conscientious staff, who have been working with——

Mr. SKELTON. Did you hear the testimony of the gentleman that just testified?

Ms. SPECTOR. Well, I do not think he said we were doing—excuse me. The gentleman just now?

Mr. SKELTON. Yes.

Ms. SPECTOR. Yes; I can defend on those couple of items.

Mr. SKELTON. Mainly, it is a matter of complying with the law. Go ahead. I do not mean to interrupt.

Ms. SPECTOR. Well, I can explain why those things——

Mr. SKELTON. Let us go ahead.

Ms. SPECTOR. OK. Let me——

Mr. SKELTON. We want to hear you.

Ms. SPECTOR [continuing]. Get through this quickly.

It has become standard practice for us to get public comment on everything that we do, and upon completion of that period, the comments are analyzed and we make changes to proposed coverage when appropriate, and we do, in preparing our final regulatory flexibility analysis and certification, consider those public comments.

We do not have an awfully good data base on the economic impact on small business of some of the things that we do. An example would be, there is a law that came out forbidding reimbursement for the costs of alcholic beverages. It is very difficult for us to assess what impact that is going to have on small business.

Our data tends to be——

Mr. SKELTON. But does the law say you are supposed to do that first?

Ms. SPECTOR. We do. We try to do the analysis, but the law says we have to do it with our final rule. Frequently, until we get the comments coming in, we do an initial analysis. Based on the comments that come in, we change our rules for final analysis. We do not put out the coverage. We put it out for comment. Based on the comments, we do our final analysis.

We try to do the assessment. Bear in mind, most of what we have done in the past 2 years has been mandated by law with no hearing for small businesses. Alcoholic beverages is one of those areas. Small businesses have been asked to provide alternatives to the DAR Council so that we can consider those alternatives. We have gotten virtually no alternatives provided during the public comment period.

We, by the way, fully support measures to relieve small business of burden and regulations. Burden that we impose are paid for in the form of the price of our contracts. So, we have a major, major incentive not to impose burdens unnecessarily.

We do impose a lot of burden, and I know that, and I am concerned with the very issues that you referred to before.

All our contracting actions under $10,000 are reserved for small business. Over that amount, we provide in the FAR that where there are at least two qualified small businesses to compete for solicitation, that item is set aside. Seventy percent of our actions go to small business and because of this participation, we try to be conscious of small business concerns with our contracting procedures.

Notwithstanding our support and participation by small businesses, we are not comfortable with RFA as it is applicable to contract regs. We do not engage in——

Mr. SKELTON. I decided you cannot be successful in the military unless you use acronyms or abbreviations.

Ms. SPECTOR. Regulatory Flexibility Act.

Mr. IRELAND. May I interrupt?

Ms. SPECTOR. Sure.

Mr. IRELAND. Why are you not comfortable with it?

Ms. SPECTOR. Well——

Mr. IRELAND. Why should you countenance that the policy of this Government should be to make you comfortable? The policy is to get the best for the taxpayer.

Ms. SPECTOR. I agree.

Mr. IRELAND. You have already acknowledged that, and now you are telling us that you are not comfortable with it. That is ridiculous.

Ms. SPECTOR. May I explain one good reason? It takes us a terribly long time to promulgate any rule. It takes us an average——

Mr. IRELAND. Why does it take you so long? Maybe you are incompetent.

Ms. SPECTOR. Well, I do not believe that is really the case. It takes us about 270 days under the FAR.

Mr. **Ireland**. Why is that?

Ms. **Spector**. Part of it is the public comment period which is at least 30 days, and the analysis of that period takes 30 days.

Mr. **Ireland**. Then, you said that you wait until that and get a final rule and then you are supposed to go back and do this analysis before you get to the final rule. Why were you not working on the analysis?

Ms. **Spector**. We are.

Mr. **Ireland**. The final rule—you just got through telling me that you waited until the end.

Ms. **Spector**. No; that is not really what I got through telling you.

We do an analysis initially when we put the rule out for public comment. We do not——

Mr. **Ireland**. You do it before you put the rule out?

Ms. **Spector**. Yes, sir.

Mr. **Ireland**. Well, we have not heard that from the Small Business Administration.

Ms. **Spector**. We do.

Mr. **Ireland**. What is all this——

Ms. **Spector**. We do an interim analysis. We do not have an awfully good data base to assess the impact on a lot of——

Mr. **Ireland**. Why do you not get that data base? Do you all live in a dreamworld? You have been doing business with these businesses for years.

Ms. **Spector**. Sir, let me give you an example.

Mr. **Skelton**. May I interrupt?

Ms. **Spector**. Sure.

Mr. **Skelton**. What makes the businesses you deal with different from the businesses that the EPA deals with?

Mr. **Ireland**. They are certainly able to do it.

Mr. **Skelton**. They are doing it.

Ms. **Spector**. Well, let me give you an example. Technical data, which is one that was raised before. The subject of technical data, there is no small business impact that is the same on all small business——

Mr. **Ireland**. The EPA, I will guarantee you, does business with people that deal with technical data. You do not live in the specialized world that you would like to think you live in.

Ms. **Spector**. Let me explain what I mean. There is no monolithic impact of technical data. On the one hand, we have a cadre of small businesses that the National Tooling and Machine Institute, that want us to get tougher, to acquire all data so that they can compete and become second sources on items for which we now buy sole source because of proprietary data. They want us to acquire all the data.

When we take initiatives to toughen our rules to acquire all this data, we have many small businesses coming in with the very valid concern that their whole company is dependent on one piece of proprietary data, and if we insist on buying that, taking it, making it expire at a time period, we are putting them out of business.

It is very difficult to balance those kinds of interests and to develop the data base that enables that balance. We are working hard at it, and I think we have achieved a fairly good compromise on it. We have an interim rule out that is pending now on technical data, but there is no monolithic small business impact on that.

Let me take the two issues that were discussed before. One was progress payments, and the other was reasonableness.

The reasonableness cost principle does not apply to 80 percent of the small businesses that we do business with.

Mr. IRELAND. Repeat that.

Ms. SPECTOR. The reasonableness cost principle makes contractors show us why the costs that are included in their costs, in their proposals, or in their rates, are reasonable. It makes them prove to us rather than our having to prove to them their unreasonableness.

This is based on a law that was in section 933 of the authorization act last year. This reasonableness shifts the burden of proof. It does not apply or affect 80 percent of the small businesses that we deal with because they are bidding firm fixed price, and we do not get into the areas of overhead rates——

Mr. IRELAND. How many businesses?

Ms. SPECTOR. I am sorry. I will get you that answer.

Mr. IRELAND. Well, the other 20 percent is a sizeable number of businesses.

Ms. SPECTOR. It certainly is.

Mr. IRELAND. OK, just because it is small, you are not going to do anything with them.

Ms. SPECTOR. No.

Mr. IRELAND. Let me ask you this.

Ms. SPECTOR. That is not really——

Mr. IRELAND. Let us get to the heart of this. For example, in 1983, without prior notice or an opportunity for the public to comment, DOD changed their procurement rules to exempt all small purchase buys from public bid posting requirements. Suddenly, small businesses which relied on this relatively simple method of obtaining notice of small buy opportunities had their ability to bid on these buys radically altered.

This change was imposed with no public analysis of whether Federal procurement practices would be improved by its adoption.

Now, are you going to tell me that the new law had not come into act before that? I am going to tell you that Senator McCarren, who was the author of the Administrative Procedures Act in 1944, said, certain war and defense functions are exempted under the bill, but there is no exemption for the War or Navy Departments in the performance of their other functions, and you have already outlined in your remarks to the chairman that so much of what you do has nothing to do with technical military activities. It is acquiring relatively mundane things.

How can you sit here and do something like that and tell us in good conscience that this is so hard to do, that you are not supposed to do it, and, that logic would not say that even if you were not required to do it, good sense would say that you should do?

Ms. SPECTOR. In the case that you describe, I think we realized that what we had done was in error, and we revoked it, and we got the comments in, saying that we were in error in not posting notice, and we changed it.

We realized we should not have done it. It did have a major impact. What I am really telling you——

Mr. **Ireland**. You mean you have not got anybody who could have figured out that ahead of time?

Ms. **Spector**. Well, what we were finding was that our procurement lead time takes a terribly long time, and any thing that can help administratively in accelerating these procurement lead times, which have gotten very long, we try to do. We try to react to the procurement community, to help them to buy things more expeditiously.

That seemed to be an idea that might help. When we realized the impact it was having, we revoked it. We stopped doing it.

Mr. **Ireland**. But you have been doing business with these people all this time, and yet you do not have any kind of a feel of what happens, and then you say well, we do not have a data base.

Ms. **Spector**. Well——

Mr. **Ireland**. I mean, you do not have any institutional memory or knowledge, let alone a data base, of what, in good logic, doing business with people for——

Ms. **Spector**. We had a data base on quantities with small business. Not everything we do impacts every small business the same way. We do—for instance, in the law——

Mr. **Ireland**. Well, that is why you ought to be doing an analysis before you——

Ms. **Spector**. Well, we do analyses, but I am saying that we are trying very hard to do analyses, and we have been doing them every time it has been appropriate since the law came into effect.

Mr. **Ireland**. Well, before that, you should have been covered by it as well, and——

Ms. **Spector**. What I am saying is, sir, that a lot of things that we have been doing in the past 2 years have been things that the law has imposed on us to correct perceived procurement abuses, and the law gives us no flexibility to assess small business versus large business. It is universally applied.

Now, many of our rules are applied, applying to dollar values thresholds rather than smaller versus large business because we——

Mr. **Ireland**. The Regulatory Flexibility Act covers all that.

Ms. **Spector**. Well——

Mr. **Ireland**. Your agency has ignored the Regulatory Flexibility Act until this last law was passed. According to the good Senator who proposed the Administrative Procedures Act, you should have been covered. Those of us, many of us in the Congress said you should have been covered. You hid under the guise that your agency was not covered.

So, we finally had to pass a law saying yes, you are covered. So, now you are having to do it, and the law, as it is, the EPA gets along well with it, everybody else gets along well with it, and you are telling us you cannot do it.

Why can you not do it?

Ms. **Spector**. I am not saying we cannot do it. I am saying we are doing it. What I am telling you, though——

Mr. **Ireland**. If——

Ms. **Spector** [continuing]. Is it takes approximately 150 hours of analysis for each rule we are analyzing.

Mr. **Ireland**. Everybody comes in here and complains about the same thing. There are those that do it and make it work and it pays off for the taxpayers of this country. Why cannot DOD do it?

Ms. **Spector**. We are not seeing the big payoff in DOD from doing it.

Mr. **Ireland**. Why?

Ms. **Spector**. So, we are doing it.

Mr. **Ireland**. Why cannot you do it and make it work when others do it and make it work? We are not talking about sophisticated equipment, high technology. We are talking about all the many other things that you do.

Why is it, instead of being so defensive, you ought to be saying, "We can do it as well as the EPA."

I mean, have you got some institutional problem in that?

Ms. **Spector**. We are not a regulatory agency. What we are doing is contracting rules that apply to the way we do business. We pay for the data that we acquire and for the information we acquire.

Mr. **Ireland**. It does not matter whether you are a regulatory agency or not. You are purchasing things. That is what we are talking about.

Ms. **Spector**. Yes.

Mr. **Ireland**. And dealing with the private sector.

Ms. **Spector**. That is correct.

Mr. **Ireland**. Fine. You can call it a regulatory agency or the XYZ kind of agency. You are still dealing with the private sector and the small business part of the private sector where this is a great opportunity to get things for less and in a more innovative way. Others are doing it. Why can DOD not do it?

Ms. **Spector**. DOD is doing it. We have been doing it ever since the law applied to us.

Mr. **Ireland**. The law applied to you before. That is only merely an opinion, and——

Ms. **Spector**. It is our lawyers' opinion that it did not. Ever since the law came in, we have been complying, and we have been trying valiantly to comply. A lot of what we did——

Mr. **Ireland**. We have testimony that people are reluctant to try to do business with your part of the Government.

Why? There has got to be a reason why.

Ms. **Spector**. I think the reason, sir, is that we have had 2 years where we have gotten so much legislation to implement, and it does not have the flexibility in it, and it is becoming extremely onerous. This proof of reasonableness is one thing. Progress payment issues that you raised before.

You know, when we instituted the 95-percent progress payment that Mr. Felty was referring to, the prime rate was about 20 percent in 1979. The prime rate this morning was about 9 percent. We lowered progress payments for that reason, to mitigate outlays.

Now, obviously, when you stop flowing more money out in progress payments, you are going to have an impact. We did the same thing with our large businesses.

Now, as far as assessing the impact, that is an interim rule. We will do the final rule. We will assess the impact.

Mr. **Ireland**. Well, why do you wait until the final rule? I mean, you ought to be assessing the impact before you put the final rule out.

Ms. **Spector**. If we do attempt to assess the——

Mr. **Ireland**. Well, what are you doing about it now? Tell us——

Ms. **Spector**. Well——

Mr. **Ireland** [continuing]. What you are doing before that final rule.

Ms. **Spector**. What we are doing is we do research and analysis and we interview small businesses. We have public meetings.

Mr. **Ireland**. Are you doing that now?

Ms. **Spector**. We are. The public meetings——

Mr. **Ireland**. I thought we were just told that the comment period was closed.

Ms. **Spector**. Yes, it was.

Mr. **Ireland**. The final rule is out?

Ms. **Spector**. No, sir, no, sir; the comment period has closed, but the final rule is not out, and we will have the final analysis with the final rule. The comment period, indeed, has closed on the rule, and we will do the final analysis, but we do meet with small business, but, you know, we have a lot of pressure on Gramm-Rudman cash-flow, is one that is going to——

Mr. **Ireland**. I was wondering when that would come up. Every bureaucrat in the world hides behind that.

Ms. **Spector**. But cash flow is a big thing on Gramm-Rudman, and having lowered the progress payment rates, which has a tremendous impact on cash flow, it is going to be very difficult for many of us who may believe progress payments ought to be slightly higher to try to get them any higher in this environment. Very difficult to do it.

We are trying to get small business input, and we do meet with them, and we do listen to them, and we cannot always go the way our own emotions tell us. There are a lot of other impacting things on procurement these days, and a lot of the impact is to get full and open competition with the same rules applying to everybody, and we try to preserve our small business set-asides and take care of our small business——

Mr. **Ireland**. Well, while we are on the subject of this, you read the testimony of the chief counsel for advocacy of the Small Business Administration. Do you agree or disagree with what he said?

Ms. **Spector**. I do not agree with all that he said, but I can go through it point by point, if you wish.

Mr. **Ireland**. Well, why not give us a written rundown, if that is all right with you, Mr. Chairman.

Ms. **Spector**. Sure. I will be glad to do that.

Mr. **Skelton**. As a matter of fact, this is getting to the point where I think that we may wish to just have a separate hearing with the Department of Defense on this issue because, quite honestly, I think we could spend a day or two on that, and I do not want to cut anybody off at this point, please, but I think that there are an awful lot of questions we would like to ask.

Mr. **Ireland**. I second that motion.

Mr. **Skelton**. I would suggest, I hope that in the imterim, you would cooperate with our staff.

Ms. **Spector**. Absolutely.

Mr. **Skelton**. Investigators and we will—I would suggest later in the summer or maybe even September, but I would think that—because I have a whole list of questions I would like to go into as well, and time prohibits us from doing that.

Mr. Coble, do you have any questions at this time?

Mr. **Coble**. Mr. Chairman, I will be very brief.

I just want to echo what the gentleman from Florida, and I think what you said, Mr. Chairman. I regard myself as prodefense, but the more I hang around this town, I see double standards imposed, and it seems to me the Pentagon waltzes around the standard that is convenient for them, and everybody else complies accordingly, and it bothers me, Mr. Ireland. I am sort of marching in tune with what you seem to be implying directly or indirectly.

I just wanted to get that on the record, Mr. Chairman.

Mr. **Skelton**. Thank you very much.

I appreciate, Mr. Ireland, your raising those points. I am sorry that time prohibits us from going all the way, and we will be in touch with you——

Ms. **Spector**. OK.

Mr. **Skelton** [continuing]. And your staff, and we appreciate your coming over so much.

Mr. **Ireland**. Thank you.

[Ms. Spector's prepared statement, with attachment, follows:]

PREPARED STATEMENT OF ELEANOR SPECTOR, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROCUREMENT, DEPARTMENT OF DEFENSE

GOOD MORNING, MR. CHAIRMAN, AND MEMBERS OF THE SUBCOMMITTEE. I AM PLEASED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO PRESENT MY VIEWS ON THE REGULATORY FLEXIBILITY ACT OF 1980 AND ITS IMPLEMENTATION WITHIN THE DEPARTMENT OF DEFENSE. I HAVE PREPARED THIS STATEMENT IN A FORMAT WHICH FOLLOWS THE SEQUENCE OF QUESTIONS ASKED BY THE SUBCOMMITTEE IN ITS LETTER OF MARCH 25, 1986, TO THE SECRETARY OF DEFENSE.

BACKGROUND

THE REGULATORY FLEXIBILITY ACT (RFA) OF 1980 (5 U.S.C. 601-612) WAS ENACTED TO ENSURE THAT FEDERAL REGULATORS CONSIDER THE IMPACT OF GOVERNMENT REGULATIONS UPON SMALL ENTITIES. UNTIL 1984, THE RFA DID NOT APPLY TO THE DEPARTMENT OF DEFENSE INCLUDING DEPARTMENT OF DEFENSE PROCUREMENT RULEMAKING. THE RFA SPECIFICALLY APPLIES ONLY WHEN AN AGENCY IS REQUIRED TO PUBLISH A GENERAL NOTICE OF PROPOSED RULEMAKING PURSUANT TO THE ADMINISTRATIVE PROCEDURE ACT OR ANY OTHER LAW. MATTERS RELATING TO A MILITARY OR FOREIGN AFFAIRS FUNCTION OF THE UNITED STATES OR MATTERS RELATING TO AGENCY MANAGEMENT, PERSONNEL, OR TO PUBLIC PROPERTY, LOANS, GRANTS, BENEFITS, OR CONTRACTS ARE EXEMPT FROM THE RULEMAKING PROVISIONS OF THE ADMINISTRATIVE PROCEDURE ACT. THE DEPARTMENT OF DEFENSE IS NOT A REGULATOR OR REGULATORY AGENCY AS ARE THE FOOD AND DRUG ADMINISTRATION, SECURITY AND EXCHANGE COMMISSION, ENVIRONMENTAL PROTECTION AGENCY, AND SIMILAR FEDERAL AGENCIES.

HOWEVER, IN OCTOBER 1984, CONGRESS ENACTED THE SMALL BUSINESS AND FEDERAL PROCUREMENT COMPETITION ENHANCEMENT ACT OF 1984 (P.L. 98-577), WHICH AMENDED THE OFFICE OF FEDERAL PROCUREMENT POLICY (OFPP) ACT (41 U.S.C. 401-419). THIS AMENDMENT PROVIDES THAT NO PROCUREMENT POLICY, REGULATION, OR PROCEDURE THAT HAS A SIGNIFICANT EFFECT BEYOND THE INTERNAL OPERATING PROCEDURES OF THE AGENCY OR A SIGNIFICANT COST OR ADMINISTRATIVE IMPACT ON CONTRACTORS OR OFFERORS MAY TAKE EFFECT UNTIL 30 DAYS AFTER IT IS PUBLISHED FOR PUBLIC COMMENT IN THE FEDERAL REGISTER. (SEE 41 U.S.C.418B.) BECAUSE THE RFA APPLIES WHEN AGENCIES ARE REQUIRED "BY ANY OTHER LAW" TO PUBLISH A GENERAL NOTICE OF PROPOSED RULEMAKING, PUB. L. 98-577 INDIRECTLY TRIGGERED THE APPLICATION OF RFA TO PROCUREMENT REGULATIONS.

IMPLEMENTATION

THE DEPARTMENT IS COMPLYING WITH THE RFA AS IT AFFECTS PROMULGATION OF PROCUREMENT REGULATIONS. WITHIN DOD, PROCUREMENT REGULATIONS ARE UNDER THE COGNIZANCE OF THE DEFENSE ACQUISITION REGULATORY (DAR) COUNCIL WHICH IS COMPOSED OF REPRESENTATIVES OF EACH OF THE SERVICES, THE DEFENSE LOGISTICS AGENCY AND NASA. THE DAR COUNCIL PUBLISHES AND MAINTAINS THE FEDERAL ACQUISITION REGULATION (FAR) JOINTLY WITH THE CIVILIAN AGENCY ACQUISITION (CAA) COUNCIL, AND IS ALSO RESPONSIBLE FOR DOD UNIQUE PROCUREMENT PROCEDURES CONTAINED WITHIN THE DOD FAR SUPPLEMENT (DFARS).

WHENEVER IT IS DETERMINED THAT A PROPOSED REVISION MAY HAVE A SIGNIFICANT ECONOMIC IMPACT UPON A SUBSTANTIAL NUMBER OF SMALL ENTITIES, DAR COUNCIL PROCEDURES REQUIRE THAT AN INITIAL REGULATORY FLEXIBILITY ANALYSIS BE PERFORMED. CONVERSELY, WHERE NO IMPACT IS FORESEEN, A DRAFT

Certification containing the rationale supporting that determination is required. In both circumstances, the potential impact upon small entities is carefully considered by the DAR Council before a proposed rule is published for public comment in order to reduce or eliminate undue burden.

The Federal Register notice incorporating a proposed rule calls public attention to the Council's intended disposition of RFA issues. For example, where there is no substantial impact upon small entities, notice is given to the public of such belief and the rationale upon which it is based. Similarly, where an Initial Regulatory Flexibility Analysis has been prepared, the Federal Register notice states that fact and announces the availability of the analysis for public review. In both situations, it has become standard practice for the Federal Register notice incorporating a proposed rule to request public comment concerning potential impact upon small entities.

Upon completion of the public comment period, comments are analyzed and resolved through appropriate changes to proposed coverage. Public comments concerning impact upon small entities are considered during this review process in order to further reduce undue burden. Additionally, comments received are considered in preparing the Final Regulatory Flexibility Analysis or Certification as appropriate.

As a standard practice, the DAR and CAA Councils furnish proposed regulatory revisions to the SBA Office of the Chief Counsel for Advocacy

IN ADDITION TO THE INITIAL REGULATORY FLEXIBILITY ANALYSES OR PROPOSED CERTIFICATIONS REQUIRED BY THE RFA. THIS FURTHER MEASURE IS DESIGNED TO ENSURE COMPLIANCE WITH THE RFA.

AVAILABLE DATA USED TO DETERMINE IMPACT

ANALYSES OF IMPACT ARE DONE USING DATA DOD COLLECTS ON ALL CONTRACT ACTIONS OVER $25,000. THE DATA INCLUDES INFORMATION SUCH AS (1) THE SIZE AND DISTRIBUTION OF DOD PROCUREMENT ACTIONS, (2) THE TYPES OF CONTRACTS AWARDED, (3) THE METHODS USED IN CONTRACTING AND (4) THE NUMBER AND DOLLAR VALUE OF CONTRACTS AWARDED BY CATEGORY OF CONTRACTOR SUCH AS SMALL BUSINESS, SMALL DISADVANTAGED BUSINESS AND WOMEN-OWNED SMALL BUSINESS CONCERNS.

USING THIS DATA BASE, THE DAR COUNCIL CAN DETERMINE THE PERCENTAGE OF TOTAL CONTRACT ACTIONS AND CONTRACT DOLLARS AWARDED TO SMALL BUSINESSES BY CONTRACT TYPE AND COMMODITY. THIS INFORMATION ALLOWS A DETERMINATION OF HOW MANY SMALL BUSINESSES COULD BE AFFECTED BY THE PROPOSED RULE. THERE IS NO DATA BASE AVAILABLE WITHIN DOD THAT IDENTIFIES THE TYPES OF SYSTEMS OR PRACTICES THAT SMALL BUSINESSES MAY PRESENTLY HAVE THAT COULD OR COULD NOT ACCOMMODATE ANY PROPOSED COVERAGE. CONSEQUENTLY, THERE IS NO DATA BASE AVAILABLE TO QUANTIFY THE ECONOMIC IMPACT A PROPOSED REVISION MIGHT HAVE ON SMALL ENTITIES. THEREFORE, THE DAR COUNCIL MUST RELY ON ITS PROFESSIONAL JUDGMENT AND EXPERIENCE IN THIS RESPECT.

Identification of Alternatives

The DAR Council identifies alternatives which may impose lesser burdens on small businesses by requiring consideration of the significant factors specified in Section 603(c) of RFA.

The Council also routinely requests, through the Federal Register, comments from small businesses regarding the impact that proposed coverage may have. Small businesses are asked to provide alternatives to the DAR Council so that those alternatives can be considered in the formulation of the final rule. Moreover, in certain cases, the DAR Council has convened public meetings and on occasion has solicited public comment in advance of formulation of a proposed rule in order to further identify alternative regulatory coverage with regard to small businesses.

Benefits or Problems Resulting From The Act

The Department of Defense fully supports measures designed to relieve small businesses of unnecessary burden and regulation. Every effort is made to be sensitive to the needs and problems of small businesses in competing for Government contracts. We provide for small business participation in DoD contracting in several ways. For example, all contracting actions under $10,000 are reserved for small business. Over

THAT AMOUNT, THE FAR PROVIDES THAT WHEN THERE ARE AT LEAST TWO (2) QUALIFIED SMALL BUSINESSES TO COMPETE FOR A SOLICITATION, THAT ITEM IS SET ASIDE FOR SMALL BUSINESSES. SEVENTY (70) PERCENT OF DOD CONTRACT ACTIONS GO TO SMALL BUSINESSES WITH HALF OF THOSE SET ASIDE EXCLUSIVELY FOR SMALL BUSINESSES. BECAUSE OF THIS PARTICIPATION WE ARE CONSCIOUS OF SMALL BUSINESS CONCERNS WITH OUR CONTRACTING PROCEDURES.

NOTWITHSTANDING OUR SUPPORT FOR SMALL BUSINESS, THERE ARE SEVERAL REASONS WHY WE FIND THE RFA IS NOT APPROPRIATELY APPLICABLE TO GOVERNMENT CONTRACT REGULATIONS. FIRST, FEDERAL CONTRACTING AGENCIES DO NOT ENGAGE IN A SUBSTANTIAL AMOUNT OF "LEGISLATIVE" RULEMAKING AS DO THE REGULATORY AGENCIES. RATHER, FEDERAL CONTRACTING AGENCIES GENERALLY PROPOSE RULES AND CONTRACT CLAUSES TO IMPLEMENT STATUTORY REQUIREMENTS OR TO ESTABLISH THE TERMS AND CONDITIONS UPON WHICH THEY WILL ACQUIRE SUPPLIES AND SERVICES. FEDERAL CONTRACTING AGENCIES, TO THE EXTENT THEY IMPOSE ADDITIONAL BURDENS ON THE PUBLIC IN ACQUIRING SUPPLIES AND SERVICES BY CONTRACT, MUST PAY FOR THE COST OF THE ADDITIONAL BURDENS IN THE FORM OF INCREASED PRICES FOR THE SUPPLIES AND SERVICES BEING ACQUIRED. I DO NOT BELIEVE LARGE SEGMENTS OF THE PUBLIC ARE NOT BEING INVOLUNTARILY BURDENED WITH THE COSTS OF COMPLYING WITH A CONTRACT CLAUSE OR REGULATION.

SECOND, IT IS GENERALLY NOT FEASIBLE TO PUBLISH SEMI-ANNUAL AGENDAS REGARDING FUTURE PROCUREMENT RULEMAKING AS THE RFA REQUIRES. THE PURPOSE OF THIS PROVISION IS TO GIVE ADVANCE NOTICE TO SMALL ENTITIES TO BETTER ENABLE THEM TO PARTICIPATE IN THE FORMATION OF A RULE. REVISIONS TO

PROCUREMENT REGULATIONS ARE GENERALLY NOT ADOPTED IN A MANNER WHICH PERMITS ADVANCE NOTICE. RATHER, REVISIONS ARE LARGELY PROMULGATED IN RESPONSE TO LEGISLATION OR TO ACQUISITION PROBLEMS WHICH CANNOT BE READILY FORESEEN.

THIRD, THE PREMISE OF RFA THAT FLEXIBLE RULES CAN BE ADOPTED BASED UPON THE SIZE OF THE ENTITY INVOLVED GENERALLY DOES NOT LEND ITSELF TO PROCUREMENT RULEMAKING. PROCUREMENT RULES NORMALLY REQUIRE UNIFORM APPLICATION SO AS TO PLACE ALL OFFERORS SEEKING TO DO BUSINESS WITH THE FEDERAL GOVERNMENT ON AN EQUAL BASIS. RECENT PROCUREMENT LEGISLATION, SUCH AS THE COMPETITION IN CONTRACTING ACT, HAS GENERALLY ADOPTED A UNIFORM APPROACH AND HAS AFFORDED LITTLE DISCRETION TO CONTRACTING AGENCIES TO FORMULATE FLEXIBLE RULES. WHERE DISCRETION IS AFFORDED, IT IS OFTEN THE CONTRACT DOLLAR AMOUNT RATHER THAN THE SIZE OF THE OFFEROR WHICH PERMITS DISCRIMINATION IN THE APPLICATION OF RULES. THIS DOLLAR VALUE APPROACH IS COMMONLY ADOPTED IN LEGISLATION IN ORDER TO AFFORD EQUALITY.

FOURTH, WHEN WE HAVE SOLICITED PUBLIC COMMENTS REGARDING IMPACT ON SMALL BUSINESSES PRIOR TO DRAFTING PROPOSED RULES, THERE HAS BEEN LITTLE PUBLIC COMMENT REGARDING SUCH IMPACT. WHAT INPUT WAS RECEIVED EITHER DID NOT HAVE SUPPORTING RATIONALE OR FAILED TO PROVIDE ALTERNATIVES.

CONCLUSION

WHILE DOD UNDERSTANDS THE CONCERNS OF THIS SUBCOMMITTEE AS IT PERTAINS TO THE PARTICIPATION OF SMALL BUSINESSES IN DOD PROCUREMENT, DOD HAS NO EVIDENCE WHICH SUGGESTS THAT RFA HAS BEEN OF MATERIAL BENEFIT TO SMALL ENTITIES IN PROCUREMENT RULEMAKING. IT HAS, HOWEVER, COMPLICATED THE RULEMAKING PROCESS. NEVERTHELESS, DOD HAS ATTEMPTED TO FAITHFULLY IMPLEMENT RFA REQUIREMENTS SINCE THE EXEMPTION FROM COMPLIANCE WAS INDIRECTLY REMOVED IN OCTOBER 1984 THROUGH THE PASSAGE OF PUB. L. 98-577.

I APPRECIATE THE OPPORTUNITY TO PRESENT THE VIEWS OF THE DEPARTMENT OF DEFENSE WITH RESPECT TO THE RFA AND TO PARTICIPATE IN THIS OVERSIGHT HEARING.

MR. CHAIRMAN, THIS CONCLUDES MY STATEMENT.

AVERAGE ACQUISITION REGULATION PROCESSING TIME
(CALENDAR DAYS REQUIRED)

	FAR SYSTEM	DAR SYSTEM
INITIAL ACTION	10	10
SUBCOMMITTEE REFERRAL	30	30
DARC CONSIDERATION	30	30
CAAC REVIEW AND RECONCILIATION	60	~~70~~ 0
PUBLIC COMMENT PROCESS	70 (mandatory)	up to 70 (discretionary)
* RESOLUTION OF PUBLIC COMMENTS	60	30
	260	170 - 70 depending on whether public comment was sought
** OFPP REVIEW/COMMENTS	30	
	290	

* Approximately 30 additional days are consumed to coordinate with the Civilian Agency Acquisition Council (CAAC) to resolve differences on public comments.

** Note: The Office of Federal Procurement Policy has recently taken a more active role in promulgation, not only of proposed and interim rules, but also of final rules. They have made suggestions to the language of a final rule already agreed upon by the two councils (DARC & CAAC) which added time to the processing of the case. If this involvement by OFPP continues, we anticipate the time to process cases to be increased an additional 14 to 30 days.

Mr. SKELTON. We have a vote. I will not go to the vote because it is a parliamentary one. We do have our next gentleman we have been waiting for, the Commissioner of the Internal Revenue Service, Mr. Roscoe Egger, Jr.

We do appreciate your coming over. We have informed our committee that you were going to come on at 10. We have tried to make that possible. We appreciate your coming over rather than sending staff assistants.

TESTIMONY OF ROSCOE L. EGGER, JR., COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY PETER K. SCOTT, ASSOCIATE CHIEF COUNSEL, AND STEPHEN KROLL, ASSISTANT TO COMMISSIONER

Mr. EGGER. Thank you, Mr. Chairman.

Mr. SKELTON. I might say this, Mr. Egger, that so often someone will come into public service and work hard and a lot of people do not realize the sacrifices that go along with it. I understand that you are nearing the end of your commission as Commissioner, and I would like to say on behalf of those who have noticed your work that you have done an outstanding job in running a very thankless job and one where you received more criticism than praise.

But without people of your dedication, this system as well as other systems could not work. So, I pass it on to you, as we say in this area, as an atta boy. So, we look forward to hearing from you today.

Mr. EGGER. Mr. Chairman, I appreciate very much your kind comments. I am, indeed, a short-termer. I quoted somebody recently saying that he was a tenured professor nearing retirement age, and that I guess is about as free a feeling as one can get these days.

I am here in response to your request to discuss the effects of the Regulatory Flexibility Act of 1980 on the operations of the Internal Revenue Service. In addition, I would like to discuss various IRS efforts to assist small businesses.

With me here on my right is Peter K. Scott, who is our associate chief counsel—[technical]—and who is responsible for issuing IRS regulations. I also have with me Mr. Stephen Kroll who is an assistant to the Commissioner and has done a great deal of work on a number of these regulations.

Both of these gentlemen and I will be available to answer questions at the conclusion of this statement.

In the development of the rules that are likely to have a significant economic impact on a substantial number of small businesses, the Regulatory Flexibility Act requires all Federal agencies to publish a regulatory flexibility analysis that describes the impact of the proposed rules on small entities. In addition, the analysis is to include a description of alternatives that would accomplish the objectives of the rule and which would minimize the impact on small business.

However, the act applies only when an agency is required by the Administrative Procedure Act or any other law, to issue a notice of proposed rulemaking. As such, the act generally applies to legislative rules, but not to interpretative rules. Interpretative rules are designed to interpret, explain or apply laws already enacted by Congress. There is no requirement in the act for an agency to publish a regulatory flexibility analysis for interpretative rules.

Mr. SKELTON. May I interrupt you right there, sir, and maybe display a bit of ignorance?

Is there a statutory provision somewhere in our Federal Code, interpretative rules, is there such an animal?

Mr. EGGER. I do not know of any specific definition there, but I suggest this may be a phrase which permits agencies not to comply with some of the other rules and regulations as set forth in the Regulatory Flexibility Act, and I——

Mr. SKELTON. I think that is the basis for which I ask you, is there a statutory basis for this type of——

Mr. EGGER. The statutory basis, as I understand it, is the Administrative Procedures Act, which most of the opinion——

Mr. SKELTON. For an interpretative rule?

Mr. EGGER. Yes.

Mr. SKELTON. There is? OK. Thank you.

Mr. EGGER. And, I think, also, Mr. Chairman, to further answer your point, that most of the rules we identify as legislative, there is not any real quarrel about those: Those of our regulations which are legislative are fairly clear because the Congress generally says that the Secretary or his delegate shall prescribe rules to achieve certain objectives. That is the type of thing we are talking about.

Because the act does differentiate between types of regulations, and because most rules promulgated under the Internal Revenue Code are interpretative, the regulations issued by the IRS are generally not subject to the act. This position is consistent with congressional and Internal Revenue policy to apply tax laws consistently and uniformly. Unless Congress specifies to the contrary, provisions of the Internal Revenue Code are to be applied universally to all taxpayers, whether they are small or large.

When I testified before this committee in 1982, the question was raised as to whether the IRS should voluntarily publish an analysis for interpretative rules. Considering the Service's limited resources, I do not believe this would be a valuable exercise. In fact, performing the analysis could actually have a harmful effect on small businesses by delaying the regulation process.

As I mentioned, the IRS is charged with uniform application of the tax law. Absent specific direction from the Congress, the Service may not create differential rules for taxpayers. Further, we doubt that courts would uphold the application of such a rule. Since we cannot promulgate special rules, any voluntary analysis of the differential impact on small taxpayers would be of limited value. Moreover, differential application of the law could actually frustrate the stated intent of Congress. On the other hand, maintaining a uniform application of the code by extending preferential rules for small businesses to all businesses could have significant negative revenue effects.

Recognizing the need for uniform application of the tax law, the Service provides special rules for small businesses only where Congress has indicated that special rules are appropriate. For example, recently promulgated regulations on long-term contracts provide an exception for small taxpayers pursuant to the provisions of the

Tax Equity and Fiscal Responsibility Act. Under those regulations, construction contractors with gross receipts below a certain level are excepted from the comprehensive costing rules applicable to extended period long-term contracts. Similarly, section 474 of the code and the accompanying regulations provide a special rule to allow small businesses to use a single inventory pool for LIFO inventory purposes. In addition, the Service is frequently able to achieve the purpose of a statute through the adoption of de minimus rules or safe harbors. These mechanisms permit the Service to reduce burdens on both small and large businesses.

The IRS is well aware of the significant effect of its rules on the business community, both small and large. In order to refine these interpretative rules so as to minimize compliance burdens, almost all of our rules are published in the Federal Register in proposed form. This publication permits us to solicit public comments and offer the opportunity for a public hearing. By providing the actual text of proposed rules, taxpayers are able to focus on the real world problems addressed in the regulations.

Mr. SKELTON. Wait just a minute. Are we having trouble with our system? Why do you not use that other microphone, Mr. Commissioner, if you would? You are cutting out.

[Pause.]

Mr. SKELTON. Try that. If you have any trouble, give a holler.

Mr. EGGER. I might tell you also, Mr. Chairman, I am full up with a cold and my pronunciation is not so great this morning.

The volume of public comment on proposed rules has generally been extremely helpful. In almost all cases, comments we received cause changes to be made to the proposed rules before they are made final. These changes must, of course, be consistent with the statute they implement and cannot discriminate because Congress has not permitted discrimination in the statute. The IRS has for many years provided tax advice and assistance specifically aimed at small businesses. For example, "Your Business Tax Kit" is designed to be provided to operators of small businesses as they are formed. It contains all the necessary tax forms and instructions for a new businessman or woman, and is available without charge by contacting any local IRS office. Approximately 200,000 are given away each year.

Our Small Business Tax Workshops are designed to increase overall awareness of business tax responsibilities, with special emphasis on employment taxes. In a typical year, over 45,000 people attend these workshops nationwide. In this same vein, the Service participates in various clinics, conferences, and workshops sponsored by the Small Business Administration, in conjunction with universities, civic groups, and so on, on a wide variety of subjects.

Our Community Outreach Tax Assistance Program assists low to middle income people with their tax questions or problems and provides tax information seminars during and after regular business hours and on weekends to groups of small business owners. Groups requesting the assistance normally arrange for the site and the time of the seminar. In fiscal year 1985, nearly 50,000 small business taxpayers, including farmers, attended these tax information seminars.

IRS "Tax Guide for Small Business," publication No. 334, is issued annually by the IRS in cooperation with the Senate Select Committee on Small Business and the SBA. It is a nontechnical but comprehensive explanation of relevant tax laws and regulations, and includes a tax calendar to guide the tax planning activities of businessmen and women. In fiscal year 1985, some 1.9 million copies were distributed free of charge.

The Service has made definite progress in recent years in revising several forms typically used by small business, with a resulting reduction in their paperwork burden. The introduction of Form 1120-A, a U.S. Short Form Corporation Income Tax Return, was a major breakthrough in this area. We also reduced the schedule C, Profit or (Loss) from Business or Profession, from two pages to one page. The size of Form 1065, the U.S. Partnership Return of Income, was reduced from four pages to just two pages. For certain small partnerships, even a portion of these two pages may be omitted. For tax year 1986, we are working on a new Form 5500-EZ, which ultimately will reduce the paperwork burden on one-participant pension plans by allowing some 600,000 individuals to use this one and a half page form in lieu of the Form 5500-C and 5500-R.

The Service also provides films on subjects of interest to business owners and operators. "Hey, We're in Business," and "Taking Care of Business," for example, cover recordkeeping requirements, obligations to employees, tax deadlines, and IRS assistance. Through TV and group showings, we estimate over 2 million individuals have viewed these films. These films may be borrowed from local IRS offices without charge. "Taking Care of Business," the more recent of the two films, was provided to the Small Business Administration film library.

The Service, also, will continue to support practitioner institutes which have proven valuable to both tax practitioners and small businessmen and women in understanding various tax law subjects and to IRS in terms of enhanced voluntary compliance. In fiscal year 1986, this support will be provided through the Intergovernmental Personnel Act, which enables the Service to enter into reimbursable agreements with institutions of higher education and certain other organizations.

To tie together these programs and to reach the small business taxpayers we are not yet reaching, the IRS strategic plan contains an initiative to expand tax education of the self-employed taxpayer. On February 11 of this year, I approved 16 recommendations to implement this initiative, as proposed by an executive level multifunctional task force. The recommendations of the task force incorporate the comments and suggestions of officials in and out of Government, including education experts. During the study, the task force found widespread support for the initiative among IRS executives, tax practitioners, educators, other Government officials, and associations representing the small business taxpayer. A sample recommendation was to expand the Small Business Workshop Program by creating separate workshops and related workshop materials for a number of the pressing small business tax issues—for example, recordkeeping, retirement plans, deposit requirements, employment taxes, et cetera. The IRS will also provide camera-ready copies of these materials to junior colleges and community adult education programs so they can add our workshops to their agendas. Another sample recommendation was to develop direct mailings on current tax issues from IRS service centers to self-employed and small business taxpayers.

Finally, the Commissioner's advisory group, which advises me on all aspects of tax administration, has among its members representatives of the small business community. Problems affecting small businesses are frequently discussed at our group meetings.

Collectively, these items indicate the Service's commitment to helping small business meet their tax obligations in the least burdensome way.

While the Regulatory Flexibility Act has a limited application to the IRS, due to the interpretative nature of the vast majority of our rules, the Service has taken a wide range of steps to assure that its rules reflect comments from both small and large businesses. In this process, every effort is made to minimize the burden on taxpayers. In addition, we believe the Service has demonstrated a commitment to helping small businesses wherever possible. We plan to continue these activities within the limitations of our budget.

Mr. Chairman, that concludes my testimony, and we will, as I said, be happy to attempt to answer your questions.

Mr. SKELTON. Thank you so much.

Mr. Ireland.

Mr. IRELAND. Thank you, Mr. Chairman.

Mr. SKELTON. You were missed at that last vote.

Mr. IRELAND. Mr. Egger, would you support amendment to our law which would require the IRS to comply even on interpretative rules? You have told us in the past that if Congress willed it, you would comply. Would you support such an amendment?

Mr. EGGER. I would probably oppose it, Mr. Ireland, because right now we still have a backlog of well over 400 regulation projects, and the difficulties of getting the guidance out to the taxpaying public are enormous. If we had to go through and effect a regulatory flexibility analysis on every one of our interpretative regulations, it could not do anything but slow down that process even more.

Mr. IRELAND. Have we not confused some thing here? Your ability to deal with a part of our economic population that is being hard pressed, as you make them comply with the same rules and regulations as General Motors.

Just because you are busy, does that make it correct?

Mr. EGGER. I do not think it is wholly a question of being busy. For the most part, the regulatory flexibility analysis would not do much good because most of our rules simply reflect what the statutory requirements are anyway, and there is no room there for differentiating. So——

Mr. IRELAND. Now, wait a minute. There are problems here.

We have found in all other parts of the Government that there is a differential impact on small business and big business, and I am sure you have wondered around the tax world. I would be dumbstruck if you said that there is not an impact from a professional standpoint. There is a great enough impact that we have successfully passed the Regulatory Flexibility Act, and it is, in large part, being complied with with great success. How could you say that your regulations are any different at the IRS?

Mr. **Egger**. Well, I am simply saying that our regulations apply by describing the mechanics, et cetera, applying the statutory rules, and we do not have authority to differentiate between tax——

Mr. **Ireland**. That is right. I am saying what if we have an amendment that says you ought to differentiate? We found that regulations in the rest of the world have a different impact on the two. IRS regulations, I am sure you would agree, have different impact on large and small from your professional background.

Mr. **Egger**. They certainly do.

Mr. **Ireland**. They certainly do. Now, why, having said what you just said, that they certainly do, and if we legislatively require you to do what I think you ought to be doing anyway, why would you not support it?

Mr. **Egger**. Well, I think what you are talking about is writing a separate Internal Revenue Code for small business, and if the Congress does that and they enact it——

Mr. **Ireland**. Well, we are not representing a separate EPA Code for small business. We are just telling EPA under regulatory flexibility to take into consideration that it affects them both.

You say professionally you know that it affects them both. Why cannot the IRS do it? Why would you not support it?

Mr. **Egger**. What I am trying to say is that if a statutory rule says taxpayers will do thus and so, that we have no authority to say, but in the case of small taxpayers, they do not have to do that or they can——

Mr. **Ireland**. Well, you are relying on your view that you are not covered by regulatory flexibility, and I disagree with that.

Mr. **Egger**. No; I am pointing out the fact that——

Mr. **Ireland**. Let me give you an example—let me read this to you.

> On September 18, 1985, the Internal Revenue Service issued proposed rules which would require certain categories of information returns to be filed by employers by magnetic media. This rule is clearly legislative in nature, and subject to the requirements of the Regulatory Flexibility Act.
>
> In prescribing these regulations, the IRS was also statutorily charged with considering the ability of taxpayers to comply at a reasonable cost with the filing requirements. However, no cost estimate or other economic impact analysis was performed. Furthermore, the IRS erroneously certified the rule as having no small business impact.
>
> The chief counsel of advocacy for the SBA strenuously objected both to the Regulatory Flexibility Act's certification and to IRS' failure to comply with Congress' specific directive that any such rule take cost impact into account.

Now, that was legislatively mandated and you did not even do it.

Mr. **Egger**. Well, we think we did.

Mr. **Ireland**. What is your comment?

Mr. **Egger**. In the sense that in attempting to determine the level at which we would require that information returns be supplied on magnetic media, we took into account relative costs and we also provided——

Mr. **Ireland**. No cost estimate analysis was performed, and you have never produced any and now you are telling me you did, but that is not the case.

Mr. **Egger**. Well, we have examined the variety of——

Mr. **Ireland**. Well, could you show us your analysis? We would like to have, for our record, your analysis. You are saying you did it. Now, you produce it for us.

Mr. **Egger**. Yes; I am saying that we got information relative to the cost. We got it from comments on the——

Mr. **Ireland**. Would you produce that for us?

Mr. **Egger**. I can give you what we have on it, yes.

Mr. **Ireland**. I must note from the way you answer, you are not saying very much.

Mr. **Egger**. You are saying, "Did you go out and do a whole separate study"——

Mr. **Ireland**. They are saying that there is no analysis. You are saying that there is an analysis. For the record, we would like to see your analysis.

Mr. **Egger**. We will provide you with the information that we have.

Mr. **Ireland**. No, no; you said you had an analysis. I do not want just information. I want that analysis that you say that you have. You are not going to give it to me?

Mr. **Egger**. We are just going to sit here and debate all day long over the words, Mr. Ireland. What I am trying to say to you is that we looked into it. We have some information on costs. We paid attention to that.

Mr. **Ireland**. Are you——

Mr. **Egger**. And it is going to be one of the criteria——

Mr. **Ireland**. Do you dispute the legislative intent was for you to do an analysis, correct? It is in there statutorily. Do you disagree with that.

Mr. **Egger**. I do not disagree with the fact that we were required to make an analysis. We concluded in this case that that analysis would not make any difference.

Mr. **Ireland**. Oh. So, you decided to ignore the fact that you were supposed to have an analysis?

Mr. **Egger**. No; I do not think we ignored it.

Mr. **Ireland**. Well, Mr. Chairman, with your permission, could we request that analysis? I would like to see it. They were statutorily asked to do it. I would like to see it.

Mr. **Skelton**. Can you produce it, Mr. Commissioner?

Mr. **Ireland**. We are not dealing with secrets that have to do with the bombing of Libya now.

Why do you not just produce what you have? If you do not regard it as an analysis, how about giving us your thoughtful comments on why you did not comply with the legislative directive? That should end it.

Now, let me ask you this.

Mr. **Skelton**. Excuse me. You will produce those for us?

Mr. **Egger**. I will be glad to give a statement for the record on——

Mr. **Ireland**. No, no.

Mr. **Skelton**. No; just a minute. Not a statement. We would like to have what you did.

Mr. **Egger**. What we did.

Mr. **Skelton**. Yes.

Mr. **Ireland**. In the analysis.

Mr. **Egger**. We did not make an analysis.

Mr. **Ireland**. Oh, no; you did not make an analysis.

Mr. **Egger**. Not specifically.

Mr. **Ireland**. Oh. Well, now, along with producing what you did do, give us a little rundown on why you did not comply with the statutory requirements.

Mr. **Egger**. Well, I think we have complied with the statutory requirements.

Mr. **Ireland**. Give us an analysis why you did not comply.

Mr. **Egger**. We will give you that for the record, yes.

[The requested information follows:]

OFFICE OF CHIEF COUNSEL
Internal Revenue Service
Washington, DC 20224

JUL 18 1986

Honorable Ike Skelton
Chairman, Subcommittee on Exports and Special Problems
Committee on Small Business
Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Skelton:

I would like to thank you for the opportunity to supplement the record of the Subcommittee's hearing of April 16, 1986, on implementation of the Regulatory Flexibility Act. Before his departure, Commissioner Egger asked me to provide additional information to the Subcommittee concerning the regulations requiring certain returns to be made on magnetic media. This letter responds to the Subcommittee's request for information on (1) the applicability of the Regulatory Flexibility Act to the magnetic media regulations, and (2) the implementation of the statutory directive that those regulations take into account the ability of taxpayers to comply at a reasonable cost.

Turning first to the applicability of the Regulatory Flexibility Act, it is evident from the transcript of the hearing that there is some confusion as to the reasons for not performing a regulatory flexibility analysis in this case. One reason, and the only reason discussed at the hearing, for not performing a regulatory flexibility analysis is that a set of regulations is interpretative rather than legislative. Interpretative regulations are not subject to the Regulatory Flexibility Act because the Act applies only to regulations for which a notice of proposed rulemaking is required and a notice is required only for legislative regulations. This is not, however, the reason that a regulatory flexibility analysis was not performed for the magnetic media reporting regulations.

The Regulatory Flexibility Act provides that a regulatory flexibility analysis is not required if the head of the agency that is proposing a rule certifies that the rule, if promulgated, will not have a significant economic impact on a substantial number of small entities (5 U.S.C. 605 (b)). In the notice of proposed rulemaking published on September 18, 1985 (50 FR 37871), it was certified that the adoption of the magnetic media reporting regulations would not have a significant economic impact on a substantial number of small entities.

Department of the Treasury

It is the position of the Service that a regulation should be treated as not having a significant economic impact if its impact flows directly from the underlying legal authority. The Service believes that the underlying authority, section 6011 (e) of the Internal Revenue Code, clearly contemplates that small entities will be subject to the magnetic media reporting requirement. In fact, there is considerable evidence that the impact of the regulations on small entities is less than was contemplated by the underlying statute. The regulations generally require magnetic media reporting only if 250 or more returns of a particular type are filed for a calendar year or other annual period. By way of contrast, the legislative history of section 6011 (e) cited as a reason for change the fact that in the most recent year for which statistics were available over 14,500 reporters filed 200 or more returns each on paper. Moreover, section 6011 (e) (2) requires magnetic media filing for certain returns in any case in which more than 50 such returns are filed for a calendar year. (The statute even authorizes a rule requiring magnetic media filing of single returns. The specific exemption for income tax returns of individuals, estates, and trusts implies that, in other cases, the filing of a single return might appropriately be subject to the magnetic media requirement. Currently, however, the Service requires magnetic media filing of single returns only in the case of returns made on Form 1099-B (Proceeds from Broker and Barter Exchange Transactions).)

Another factor that contributed to the certification in this case was the waiver procedure provided in the regulations. The Service believes that the impact of a regulation on small entities must take into account not only the scope of the general rule, but also any exceptions provided. In other words, the significance of the economic impact of a regulation should be determined by reference to the rules actually issued and administered rather than to some stricter rules that might have been issued.

In this case, the general rule that requires filers of 250 or more returns to use magnetic media might have a significant impact on some small entities. The regulations provide, however, that a waiver is available for cases in which hardship is shown. The regulations further provide that the principal factor to be taken into account in determining whether hardship has been shown is the amount by which the cost of filing returns on magnetic media exceeds the cost of other forms of filing. The Service believes that in this context hardship is virtually synonymous with significant economic impact. The intended effect of the waiver procedure is that the regulations will seldom, if ever, have a significant economic impact on a small entity. (The Service has expended considerable time and effort in implementing the waiver procedure. Attached to this letter is a copy of a revenue procedure that provides general guidance on the waiver procedure.)

The second matter on which the Subcommittee requested additional information was the implementation of the statutory directive that the magnetic media regulations take into account the ability of taxpayers to comply at a reasonable cost. The transcript of the hearing indicates that the Subcommittee's understanding of this directive may differ from that of the Service. In particular, the transcript refers at several points to a legislative requirement that the Service perform a cost estimate analysis.

The Service does not agree with this interpretation of section 6011 (e). The actual statutory language is as follows: "In prescribing such regulations [requiring reporting on magnetic media], the Secretary shall take into account (among other relevant factors) the ability of the taxpayer to comply at a reasonable cost with such a filing requirement." The Service agrees that this directive could be implemented by performing a cost estimate analysis and prescribing general rules based on the results of that analysis. The Service believes, however, that this would produce inappropriate results in many cases.

Most taxpayers (including small entities) will be able to comply with the magnetic media filing requirement at a reasonable cost because of the availability of computer service bureaus. In a recent survey of these bureaus, the Service found that their current charge for magnetic media filing is between $.75 and $1.00 per return. In particular cases, however, lack of access to service bureaus or other reasons may result in excessive costs to the taxpayer. An exception from the magnetic media requirement may be appropriate in such cases, but its availability should depend on the circumstances of the particular taxpayer and is best determined on a case-by-case basis.

This is the approach adopted in the magnetic media regulations. As noted previously, these regulations provide as a general rule that filers of 250 or more returns must use magnetic media, but allow for waivers in cases in which hardship, determined principally by reference to the cost of compliance, is shown. The Service believes that this is consistent with the legislative history of section 6011 (e), which includes the following suggestion: "In addition, the Secretary could impose a general requirement for use of magnetic media in certain circumstances but provide a mechanism for case-by-case exemptions from the requirement." Because the regulations provide for cost analyses on a case-by-case basis, no general cost estimate analysis was performed in connection with the development of the regulations.

I hope this information is responsive to the concerns expressed at the hearing. Please let me know if the Service can be of any further help.

Sincerely yours,

Peter K. Scott

Peter K. Scott
Associate Chief Counsel (Technical)
Internal Revenue Service

Attachment

26 CFR 601.602: Tax forms and instructions.
(Also Part I, Section 6011, 301.6011-2.)

Rev. Proc. 86-31

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide guidance to filers of certain information returns about the procedures for requesting approval for filing such information returns on a particular form of magnetic medium, or for requesting a waiver of the magnetic media filing requirements of section 6011(e) of the Internal Revenue Code and section 1.6045-1(l) of the Income Tax Regulations.

.02 Magnetic media reporting is required for the following forms: Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments; Form W-2G, Statement for Recipients of Certain Gambling Winnings; Form 1099 Series, Information Returns; Form 1042S, Foreign Person's US Source Income Subject to Withholding; Form 1098, Mortgage Interest Statement; Form 5498, Individual Retirement Arrangement Information; Form 6248, Annual Information Return of Windfall Profit Tax; and Form 8027, Employer's Annual Information Return on Tip Income and Allocated Tips.

SEC. 2. BACKGROUND

.01 Section 6011(e) of the Code provides that the Secretary may prescribe regulations setting forth standards for determining which returns must be filed on magnetic media.

.02 Under section 6011(e)(2)(A) of the Code and section 301.6011-2(c)(2) of the Regulations on Procedure and Administration, effective for payments made after December 31, 1983, any payor of interest, dividends, or patronage dividends that is required to file returns under sections 6042(a), 6044(a), or 6049(a) must use magnetic media if the payor has more than 50 returns for any calendar year.

.03 Under section 1.6045-1(l)(1) of the regulations, in general, a broker or barter exchange required to file information returns must file such returns on magnetic media. Under section 1.6045(l)(2), the Commissioner may waive the magnetic media requirements upon a written showing of hardship by the filer.

.04 Under section 301.6011-2(c)(1)(i) of the regulations, effective for returns filed after December 31, 1986, a person that is required to make a return of information on a particular type of form specified in section 301.6011-2(b) (other than Forms 1099-INT, 1099-DIV, 1099-PATR, or 1099-OID) must submit such information on magnetic media if:

(A) in the case of calendar year 1986,

(1) the person reasonably expected on the first day of such year to file 500 or more return son such form, or

(2) the person was required to file 500 or more returns on such form for the 1985 calendar year, or

(B) in the case of a calendar year beginning on or after January 1, 1987,

(1) the person reasonably expects on the first day of such year to file 250 or more returns on such form, or

(2) the person was required to file 250 or more returns on such form for the preceding year.

.05 As is more fully explained in Sections 3 and 4 below, under section 301.6011-2(b) of the regulations, magnetic media filers are required to obtain prior approval from the Internal Revenue Service (IRS) or the Social Security Administration (SSA) of the medium used to report the information.

.06 Under section 301.6011-2(c)(4) of the regulations, the Commissioner may waive the magnetic media requirements upon a written showing of hardship by the filer. In determining whether hardship has been shown, the principal factor to be taken into account is the amount, if any, by which the cost of filing returns using magnetic media exceeds the cost of filing returns on paper forms. Except in the case of returns on Forms W-2 and W-2P for 1986 or 1987 (which are filed in 1987 and 1988, respectively), a request for waiver msut be filed at least 90 days before the filing of the first return for which a waiver is requested. In the case of 1987 returns on Forms W-2 and W-2P filed in 1988, a request for waiver must be filed on or before June 30, 1987. In the case of 1986 returns on Forms W-2 or W-2P filed in 1987, under the current regulations, a request for waiver must be filed on or before June 30, 1986; however, on June 18, 1986, the IRS announced that the regulations would be amended to permit requests for waiver to be filed on or before July 31, 1986, in the case of 1986 returns on Forms W-2 and W-2P filed in 1987.

.07 There may be situations in which the filer is seeking approval for filing on a particular form of magnetic medium for some forms and requesting a waiver from filing on magnetic media for other forms, or the filer may be unsure whether its mangetic medium is compatible with the IRS's or with the SSA's systems, or whether its waiver request will be granted. In such cases, because applications for approval of the filer's particular form of magnetic medium are due at the same time as requests for waivers from filing, certain filers may seek approval or waiver, as alternatives, by filing a single application. Filers must follow procedures outlined in Sections 3 and 4 below.

SEC. 3. APPLICATION FOR MAGENTIC MEDIA REPORTING AND REQUESTS FOR UNDUE HARDSHIP WAIVERS

CONSENTS

.01 All filers of information returns, *other than Forms W-2 and W-2P*, must obtain approval of their magnetic medium from the IRS before their first filing on magnetic media by submitting form 4419, Application for Magnetic Media Reporting of Information Returns, to the address listed in Section 3.05 below, at least 90 days before filing the return.

.02 The IRS will review Form 4419 and, if acceptable, will send an authorization letter within 30 days. Do not submit magnetic media until the IRS sends authorization to do so.

.03 Requests for consent to file Forms W-2 and W-2P on magnetic media *must* be submitted to the SSA. See Section 4 for additional information.

WAIVER REQUESTS

.04 Generally, all waiver requests, including requests for waiver from filing Forms W-2 and W-2P on magnetic media, *must* be sent by the filer to the IRS. However, if, in a single application with the SSA, the filer is submitting a request to file Forms W-2 and W-2P on a particular form of magnetic medium and, alternatively, seeking a waiver from the magnetic media filing requirements in the event approval is not granted, the SSA will forward the waiver request to the IRS. See Section 4 below.

.05 Effective January 1, 1986, magnetic media processing for all the IRS service centers was centralized at the national Computer Center. Forms 4419 and waiver requests should be directed to the following address:

Magnetic Media Reporting
Internal Revenue Service
National Computer Center
P.O. Box 1359
Martinsburg, WV 25401-1359

.06 Filers must submit a written statement requesting a waiver for a specific period, *not to exceed one year*. Waivers are granted on a case-by-case basis, and filers may not apply for a waiver for more than one year at a time. Separate waiver requests must be filed for each type of form. Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, may be used for this purpose. If it is not used, a written statement shoudl be filed containing the following information:

(a) The filer's name and address.

(b) The filer's taxpayer identification number.

(c) The tax year for which the waiver is requested.

(d) The name and telephone number of a person to contact who is familiar with the information contained in the waiver request.

(e) The form number for which the waiver is requested.

(f) The type and expected volume of each return for the tax year for which a waiver is requested and the number and type of returns to be filed on magnetic media, if any.

(g) If the filer does not currently have a magnetic media system, a cost analysis that shows the cost to convert from the filer's current paper system to a magnetic media system compatible with the IRS's or SSA's systems. Specify the type of magnetic medium considered, such as tape, cartridge, cassette, mini-disk or diskette, and

(1) a copy of a written cost estimate for magnetic media filing from two service bureaus, or

(2) written statements from at least two service bureaus indicating that they will not handle the volume of documents required by the filer.

(h) If the filer has a magnetic media system that is incompatible with the IRS's or SSA's system, or is currently in the process of installing a magnetic media system:

(1) a firm date by which the filer's system will be capable of providing a form of magnetic medium that is compatible, or

(2) a written commitment of a date from a service bureau that will convert the returns to magnetic media.

(i) In the case of Form W-2 filers, the number of permanent employees for whom Forms W-2 will be filed and the total number of employees, if different, for whom Forms W-2 will be filed.

.07 The waiver request must contain the following statement signed by a responsible person who is duly authorized to make and sign a return, statement, or other document:

> "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief the facts presented in support of this request are true, correct and complete."

.08 The IRS will notify the filer whether the request is granted or denied.

.09 With respect to returns filed on forms other than Forms W-2 and W-2P, if the filer is seeking, in a single application, approval for filing the returns on a particular form of magnetic medium and alternatively, a waiver from the magnetic media filing requirements if approval is not granted, Forms 4419 and 8508 (or a written request) should both be submitted to the IRS.

SEC. 4. PROCEDURES FOR CONSENTS/WAIVERS FOR WAGE AND PENSION INFORMATION

.01 Forms W-2 and W-2P *must* be filed with the SSA. The SSA will accept magnetic media filing for forms W-2 and W-2P and has issued the following Specification booklets: TIB-4a, "Magnetic Tape Reporting, Submitting FICA Wage and Tax Data to the Social Security Administration," TIB-4b, "Magnetic Tape Reporting, Submitting Annuity, Pension, Retired Pay or IRA Payment to the Social Security Administration," and TIB-4c, "Diskette Reporting, Submitting FICA Wage and Tax Data to the Social Security Administration." all filers must obtain approval of their magnetic medium before their first filing on magnetic media by submitting an SSA authorization request. The authorization request forms appear in TIBs-4a, 4b, and 4c. Copies of these publications are available from the SSA Regional Magnetic Media Coordinators. Filers must send authorization requests to:

Social Security Administration
P.O. Box 2317
Baltimore, MD 21203
Attn: Magnetic Media Group

.02 Upon receipt of the authorization request, the SSA will review the application and notify the filer in writing within 30 days whether its particular form of magnetic medium has been approved. In no event should a report be submitted before the SSA has approved the authorization.

.03 If the filer is seeking approval for filing on a particular form of magnetic medium and alternatively, requesting a waiver from the magnetic media filing requirements in a single application, Form 8508 (or a written waiver request) should be submitted with the authorization request. The SSA will forward the waiver request to the IRS for its consideration.

.04 A filer may submit form 8508 (or a written waiver request) directly to the IRS.

.05 Under the current regulations, the authorization request and/or the waiver request must be filed with the appropriate agency on or before June 30, 1986, in the case of 1986 Forms W-2 and W-2P to be filed in 1987; however, on June 18, 1986, the IRS announced that the regulations would be amended to permit authorization requests and/or waiver requests to be filed on or before July 31, 1986, in the case of 1986 returns on Forms W-2 and W-2P filed in 1987. The authorization request and/or the waiver request must be filed on or beofre June 30, 1987, in the case of the 1987 Forms W-2 and W-2P to be filed in 1988.

SEC. 5 APPLICABLE PENALTIES

If a filer fails to file on magnetic media when required to do so, and has not received a waiver from the filing requirements, the filer is subject to the penalties for failure to file a return under sections 6652 and 6693.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective June 18, 1986, for returns filed after December 31, 1986.

Mr. Ireland. In your meetings with small businesses, do you find, as I do, that there are few complaints about how much they have to pay, but rather they are pretty angry about the paperwork and confusing rules of the IRS? Do you find that just as much as we do?

Mr. Egger. I find it in every level of business, that the volume of paperwork on the business community generally is extremely high, and is a reflection of the complexity of our Internal Revenue Code.

Mr. Ireland. And, even in spite of that, you do not think that we ought to have a two-tiering so the smaller ones do not have to comply with the rules that make sense to the larger ones?

Mr. Egger. Well, regardless of what I think, Mr. Ireland, it is the Internal Revenue Code that is not so written, and until it is, I, as the Administrator of that particular act, do not have much——

Mr. Ireland. I do not know that it makes much difference when we statutorily ask you to do it, you do not do the analysis anyway.

That is all. Thank you, Mr. Chairman.

Mr. Skelton. I had three questions, and would you believe Mr. Ireland asked all three of them?

As I understand it, the Regulatory Flexibility Act is outside the Internal Revenue Statutory Code. Does that fact bother you or cause you to look at it differently and not desire to follow it, sir?

Mr. Egger. No; indeed.

Mr. Skelton. I am gathering that from your——

Mr. Egger. No.

Mr. Skelton [continuing]. Comments.

Mr. Egger. That is definitely not true. What I was trying to say, and did not get too much of an opportunity to say, was that we believe that the waiver provisions in our regulations, that the exceptions, the opportunity to come in for a special waiver and all those things have worked very well, and we believe will work very well. We think that that is probably the best way that we can address the problem, vis-a-vis small business as well as others.

That said, it is not a rationale acceptable to the Subcommittee, that is essentially what we went through.

Mr. Skelton. Let me reiterate. I touched on this briefly awhile ago. What criteria does the IRS use to determine whether rules are legislative or interpretative in nature? Can you assist?

Mr. Egger. Primarily, the degree of discretion that we have in applying the rules. In other words, if the statute is not specific but, rather, says this is the objective we want to achieve——

Mr. Skelton. You would apply——

Mr. Egger [continuing]. And you write rules to achieve it. We regard those as legislative; but when they say these are the rules, obviously, then they are interpretative.

Mr. Skelton. OK. This has been touched upon, but let me run over it again. Would the IRS support or oppose the current proposals to specifically include in IRS rulemaking, within the purview of the Regulatory Flexibility Act, these specifically?

Mr. Egger. Well, as I said, Mr. Chairman——

Mr. Skelton. You know——

Mr. Egger [continuing]. I am probably not going to be here long enough to personally oppose that, but I would hope that my successor would oppose it for the reasons that I explained.

Not because we are against small business or any of those things—any such conclusion is just wrong; but simply because our rules are interpretative, 90 percent of the cases at least. We do not have the authority to differentiate; so, we would be going through an exercise that would have little or no result.

Mr. SKELTON. Does the fact that you have a backlog cause you to feel this way? In other words, if you did not have a backlog——

Mr. EGGER. Well, that is a part of it, but because we feel an obligation——

Mr. SKELTON [continuing]. Would your answer be different?

Mr. EGGER. We feel an obligation to get guidance out to all taxpayers, small taxpayers, large taxpayers, so on. Anything that is not very productive will inhibit our ability to do that as quickly as possible. That, of course, does not help the business community, small business or anybody else.

Mr. SKELTON. I appreciate your coming.

Mr. IRELAND. Mr. Chairman, I was struck by the gentleman's thought that he did not think this kind of thing that he values so lowly would have any effect.

I wonder if the gentleman would comment as to whether he thought on the auto law rule that if there had been a regulatory flexibility analysis, that would have saved any pain or suffering, since they put out a rule that would have generated $150 million in new income and analysis later on showed, and thank God we changed it, that recordkeeping would have been in the neighborhood of $3 billion. You do not think that a little analysis ahead of time would have headed off that debacle?

Mr. EGGER. Maybe so. Let me read to you from the Joint Committee explanation of the statute as Congress wrote it.

It says:

> Congress expected that the contemporaneous records required to be kept by this provision of the Act must reflect with substantial accuracy the business use of the property.

It goes on to say:

> With respect to automobile contemporaneous logs, recording the date of the trip, the mileage driven for business purposes, must be kept.

It goes on to say:

> The Treasury will amend Form 2106 or any other appropriate form to require that the taxpayer directly indicate on his return whether the required records have been kept.

It goes on to say that:

> The Act also provides that any portion of an underpayment of tax attributable to a failure to comply with these contemporaneous recordkeeping requirements is treated as due to negligence.

Now, that is in the committee report, Mr. Ireland, and that is what we were responding to.

[The information referred to follows:]

[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984

(H.R. 4170, 98TH CONGRESS; PUBLIC LAW 98-369)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

DECEMBER 31, 1984

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c. Recordkeeping and compliance

The Act provides that taxpayers are required to substantiate by adequate contemporaneous records, i.e., records created at the time of the expense, any tax credit or deduction (1) with respect to the business use of listed property, (2) with respect to traveling expenses (including meals and lodging while away from home), (3) for any item with respect to an activity that is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, and (4) for any expense for gifts. However, it was not intended that these recordkeeping requirements were to apply to the extent that the expense or the use of listed property is provided as compensation and that the employer complies with withholding and reporting requirements applicable to such compensation.

If the taxpayer does not have adequate contemporaneous records, no credit or deduction is allowed with respect to that item. If, however, adequate contemperaneous records were made but then were lost due to circumstances beyond the taxpayer's control, such as a fire, flood, or earthquake, Congress intended that taxpayers continue to have the ability, as under prior law, to substantiate a deduction by reasonable reconstruction of expenditures (see Treas. reg. sec. 1.274-5(c)(5)).

Congress expected that the contemporaneous records required to be kept by this provision of the Act must reflect with substantial accuracy the business use of the property. The records must indicate the business or personal purpose of the expense or use, unless the business purpose is clear from the surrounding circumstances. With respect to automobiles, contemporaneous logs recording the date of the trip and the mileage driven for business purposes must be kept, whether or not the automobile is used for overnight travel.

The Act requires that a return preparer properly and fully advise the taxpayer of these contemporaneous recordkeeping requirements and also must obtain written confirmation from the taxpayer certifying that adequate contemporaneous records supporting these deductions and credits exist. If the return preparer does not obtain this written certification, the preparer is subject to a penalty. Congress anticipated either that the content of this certification will be specified by the Treasury or that the Treasury will prescribe a form for this certification. Congress expected that the Treasury will amend Form 2106 or any other appropriate form to require that the taxpayer directly indicate on his return whether the required records have been kept. This could be done, for example, by providing a box to check on the return.

The Act also provides that any portion of an underpayment of tax attributable to a failure to comply with these contemporaneous recordkeeping requirements is treated as due to negligence, for purposes of the penalty on underpayment of tax, in the absence of clear and convincing evidence to the contrary. Claiming a deduction or credit without the support of the required records may also be fraud for purposes of this penalty. This is in addition to the loss of the credit and deduction that would occur.

Congress anticipated that the Treasury will draw the attention of taxpayers to these new recordkeeping requirements in the appropriate regularly issued Internal Revenue Service publications. To accomplish this, for example, the Service could describe these new recordkeeping requirements in the section of the instructions to the 1984 Form 1040 that highlights important tax law changes.

Effective Date

The limits on the investment tax credit and depreciation are effective for property placed in service by the taxpayer or leases entered into by the taxpayer after June 18, 1984. However, property acquired by the taxpayer pursuant to a binding contract in effect on or before June 18, 1984, that is placed in service by the taxpayer before January 1, 1985, is not subject to these limits.

The provisions relating to a personal use property are effective for property placed in service by the taxpayer after June 18, 1984. However, property acquired by the taxpayer pursuant to a binding contract in effect on or before such date which is placed in service by the taxpayer before January 1, 1985 (or January 1, 1987, in the case of real property) is not subject to these provisions.

The recordkeeping and compliance provisions are effective for taxable years beginning after 1984, regardless of the year that the property was placed in service by the taxpayer. Thus, for example, if the owner of a business placed an automobile in service in 1981 for use in the business, the owner may claim, in taxable year 1985 and all following years, a deduction for only that portion of the use of the automobile with respect to which he has kept adequate contemporaneous records (i.e., logs) of business use.

Revenue Effect

These provisions are estimated to increase fiscal year budget receipts by $48 million in 1984, $150 million in 1985, $233 million in 1986, $269 million in 1987, $279 million in 1988, and $286 million in 1989.

Mr. **Ireland**. But if you were doing the regulatory flexibility analysis——

Mr. **Egger**. It does not say to do that.

Mr. **Ireland**. If you were doing the regulatory flexibility analysis that many of us think that you ought to be doing all along, you would have come up with that and say: "Look, in order to gain $150 million, it is going to cost the taxpayers $3 billion of extra paperwork," and maybe the debacle would not have happened.

Mr. **Egger**. Well, I think we did supply to the Congress, at the time, an indication of the significant revenue loss as a result of failure of the taxpayers across the board to report these items accurately, and the committee went on to say in the conference report of the 1984 act that they were enacting these rules in order to achieve a higher level of compliance.

Let me tell you what happened in the case of small business. Every 3 years, we do a TCMP survey.

Mr. **Ireland**. What is that?

Mr. **Egger**. That is the Taxpayer Compliance Measurement Program, which is an intensive examination of a group of scientifically selected returns using a stratified random sample. In the case of business returns, these are individual returns that have a schedule C attached. For the year 1982, schedule C business type returns with total gross receipts under $25,000, the compliance level was 64.3 percent as compared to total nonbusiness returns which had a compliance level of 94.3 percent.

In the case of schedule C's, between $25,000 and $100,000, the compliance level measured 72.4 percent. In the case of schedule C's over $100,000, the compliance level measured 75.7 percent. Compliance was the objective of that particular provision of the code, and that is what we were seeking to improve. Small business does not have any great record when it comes to complying with the tax laws.

So, what we were trying to do, was to see where the problem is and get at it.

Mr. **Ireland**. But you did not succeed in doing either of them.

Mr. **Egger**. No, no.

Mr. **Ireland**. You did not succeed in doing either of them.

Mr. **Egger**. No; that is right, that is right.

Mr. **Ireland**. You did not succeed in doing anything.

Mr. **Egger**. They decided not to do it.

Mr. **Ireland**. You could have avoided it by doing the analysis.

Thank you, Mr. Chairman.

Mr. **Skelton**. Thank you so much. We appreciate your coming and being with us today.

Mr. **Egger**. OK.

Mr. **Skelton**. We look forward to your answers and to compliance with our suggestions.

Thank you and good luck.

The next witness is Milton Russell, Assistant Administrator for Policy, Planning, and Evaluation, U.S. Environmental Protection Agency [EPA].

TESTIMONY OF MILTON RUSSELL, ASSISTANT ADMINISTRATOR FOR POLICY, PLANNING, AND EVALUATION, U.S. ENVIRONMENTAL PROTECTION AGENCY, ACCOMPANIED BY DAVID DiFIORE AND ODELIA FUNKE

Mr. IRELAND. Excuse me. Having been critical of some of the other agencies, with EPA, I want the record to show that they are impressive. They show that this whole thing can be done to the help of our own taxpayers, and I think that is really pretty good.

Mr. SKELTON. Thank you.

Mr. RUSSELL. Thank you, Mr. Chairman.

Mr. SKELTON. We will miss you, Mr. Ireland.

Mr. RUSSELL. I am pleased to be here this morning. I am accompanied by two of my staff members, Mr. David DiFiore and Dr. Odelia Funke, who have joined me here today.

Mr. SKELTON. Does the reporter have their names? You had better spell them.

[Pause.]

Mr. SKELTON. Please proceed, sir.

Mr. RUSSELL. Yes; I have a statement for the record. Because I recognize the time constraints today, I will just summarize briefly, if that would be all right.

Mr. SKELTON. Please. Without objection, the statement is entered in full.

Mr. RUSSELL. I must start today by emphasizing that the primary mission of EPA is to protect human health and the environment, but in working to accomplish that goal, we do strive to minimize the impact on the economy in general and certainly on small entities in particular.

Our guidelines for doing this with respect to small entities were under development when my predecessor appeared before the committee back in October 1981. We completed those guidelines in February 1982, and I am pleased to report that we have been successfully implementing those since.

An example of the way we do this might make the way we handle the Regulatory Flexibility Act a little more clear. Let me give you that example now. One analysis of impacts on special entities was recently performed under the Clean Water Act for effluent regulations for the metal molding and casting industry.

Now, we found that foundries, when grouped by employment size category and by major casting type—metal casting type—broke into categories of small, defined as those with less than 50 employees, and those greater than that.

Although we had our greatest concern about the number of closures that might result from proposed regulations, we also examined changes in the financial performance and in the competitiveness of these small firms. And, based on the findings from the analyses, EPA set less stringent standards for small foundries in iron subcategories and exempted magnesium foundries all together from these regulations.

These modifications enabled the Agency to assure itself and the American people that the final regulation would not cause a significant adverse economic impact on small foundries while, at the same time, continuing to *safeguard human health and environment.*

. In this case, the analyses did make a difference. A major benefit of the Regulatory Flexibility Act, however, is that it also increases the Agency's awareness of and responsiveness to the impacts of its actions on small entities whenever allowed by the law.

It should be noted that some recent legislation, such as the Hazardous and Solid Waste Act Amendments, do limit, however, the exemptions that the Agency can grant for small firms. But even in these situations, we have found that much can be done to lessen impacts.

What we do is to think carefully ahead of time about ways to tailor our behavior and our requirements so that those without the large corporate staffs and without the Washington representatives can know what is required of them and how, indeed, to comply.

Mr. SKELTON. May I interrupt?

Mr. RUSSELL. Yes, sir.

Mr. SKELTON. Sounds like you read the law.

Mr. RUSSELL. Thank you. Well, we try to.

Mr. SKELTON. Please proceed.

Mr. RUSSELL. When it comes to some of these small entities, the burdens we find can often be reduced with such careful attention without sacrificing the environmental gain. So, even if the statutes under which we operate our protective programs do not allow special treatment of these small entities, we find that education and technical assistance as well as other efforts to support compliance have become important ways of achieving the objective of the act.

Now, it is also important, I think, to note that in support of this approach in 1982 we established the position of a small business ombudsman, which is located, significantly, in the Office of the Administrator. The ombudsman aids the small business community, first, by sensitizing Agency decisionmakers about their special needs, and, second, by helping them get their concerns heard.

The ombudsman also provides communication links that offers effective two-way dialog. For example, the office of the ombudsman operates a small business hotline. It also publishes a periodic update aimed in both directions. The first points toward environmental regulatory matters, which helps business, and in the other direction, information about small business concerns, which helps our regulators.

Let me just summarize by saying that through formal implementation of the requirements of the act and through other measures that we have taken on our own initiative, EPA has been and will remain supportive of the special needs of small entities to the extent practical under our other statutes and consistent with our protective mission.

Mr. Chairman, that concludes my remarks now, and, of course, I and my staff will be happy to answer any of your questions.

[Mr. Russell's prepared statement follows:]

PREPARED STATEMENT OF MILTON RUSSELL, ASSISTANT ADMINISTRATOR FOR POLICY, PLANNING, AND EVALUATION, U.S. ENVIRONMENTAL PROTECTION AGENCY

Good morning, Mr. Chairman and members of the Subcommittee. I am Milton Russell, Assistant Administrator for Policy, Planning and Evaluation at the Environmental Protection Agency. I am pleased to appear before you today to discuss the Agency's implementation of P.L. 96-354, the Regulatory Flexibility Act of 1980.

Before addressing this topic, I must emphasize that the primary mission of EPA is to protect human health and the environment. In working to accomplish that goal, we strive to minimize adverse impacts on the economy in general and on small entities in particular.

Background

The Regulatory Flexibility Act requires that Federal agencies analyze the effects of new and existing regulations that have a significant economic impact on "small entities." Section 606 of the Act anticipates that its implementation would be consistent with other requirements of law. As defined in the Act, small entities include small businesses, local governments, and small organizations.

New regulations proposed after January 1, 1981 must be accompanied by a Regulatory Flexibility Analysis (RFA) or certification that the regulation as promulgated will not have a significant economic impact on a substantial number of small entities. Agencies must also list in the Regulatory Agenda rules being developed which may have such an economic effect.

Overview of Compliance with the Act

The Environmental Protection Agency carefully considers potential significant economic impacts on small entities. In early 1981, EPA established an Agency work group to plan for implementation of the Regulatory Flexibility Act, and to develop a set of internal guidelines. These internal guidelines were under extensive review within the Agency when EPA appeared before this Subcommittee in October of 1981.

In February of 1982, EPA formally issued those guidelines. The Office of Policy and Resource Management - predecessor to the Office of Policy, Planning and Evaluation - was assigned the responsibility of overseeing EPA's implementation of the guidelines. EPA's Regulatory Flexibility Officer is the Director of the Information and Regulatory Systems Division, part of the Office of Standards and Regulations. The director is responsible for overseeing Agency compliance with the Act, managing the regulatory review process, and directing information collection reviews under the Paperwork Reduction Act. He is also EPA's official liaison with the Small Business Administration (SBA) on matters related to the Act.

The Mechanics of Regulatory Flexibility

The EPA prepares cost and economic impact analyses, which also include analyses of the effects on small business, for many of its regulation. To date, EPA has also prepared separate, detailed small business analyses for a number of rules under the Regulatory Flexibility Act. Rules which have been subject to these two types of analyses include, for example, lead phasedown; effluent standards and limitations for the porcelain enameling industry, the metal molding and casting industry, as well as several other effluent guidelines under the Clean Water Act; revisions of drinking water regulations; an exemption for small manufacturers from the reporting requirements of section 8 of the Toxic Substances Control Act; and the Small Quantity Generator rule, as well as listings of hazardous waste and permit standards under the Resource Conservation and Recovery Act.

Under EPA's guidelines, the process for determining whether to conduct a regulatory flexibility analysis is as follows: first, the Agency must define "small entity" on a case-by-case basis. For this purpose, the Agency may either: 1) use the definitions of "small entity" in the Act, or 2) develop its own definitions by consulting with the SBA and allowing public comment.

Second, the Agency must determine whether the regulation will have a "significant impact" on a "substantial number of small entities." We make this determination on a case-by-case basis. In general, a "substantial number" of small entities is more than 20% of the total number of small entities, but the 20% rule is a guideline rather than a fixed standard. There may be cases where the intent of the Act indicates the need for an RFA when less than 20% of small entities are affected. For example, some regulations could impose such severe economic hardship on a few businesses that an RFA would be necessary, even though the total number affected might be small. EPA determines what a "significant economic impact" is by considering the differential impact on small entities. The Agency focuses on the costs of production, average profit margin, and compliance costs, cognizant of the fact that small entities frequently have higher average annual costs, lower profit margins, and therefore are less able to absorb the expense of environmental regulations.

After reviewing the magnitude of economic impact and the number of entities affected, the Agency may conclude that an RFA is unnecessary. In that case, the Administrator will certify at the time of publication of the proposed or final rule that the rule will not have an adverse impact on a substantial number of small entities. The certification must contain a succinct statement of the reasoning and criteria used to make that determination. Alternatively, the Agency may find the impact to be significant, in which case an RFA must be performed.

The Regulatory Flexibility Analysis

The Regulatory Flexibility Analysis summarizes the economic impact of a regulation on small entities and discusses alternatives that might minimize the impact and still accomplish the statutory objectives. The most sophisticated RFA would contain the following elements:

1. Explanation of Why EPA is Considering Action
2. Objectives and Legal Basis of the Rule
3. Identification of Alternatives

4. Demographic Analysis
5. Cost Analysis
6. Competitive Effects Analysis
7. Exemptions or Allowances
8. Identification of Overlapping Regulations
9. Summary of Public Comments

EPA often uses the model plant concept to measure impacts and to establish size cut-offs for regulatory exemptions. When a class of small entities has not fallen within the size cut-off, the Agency has frequently endeavored to make compliance possible through the phasing-in of regulatory programs, allowing small entities to meet Agency requirements over time.

A typical impact analysis was the one performed for the foundry industry. We grouped foundries by employment-size category and major metal casting type; small was defined as fewer than 50 employees. Although we were most concerned with determining the number of closures that might result from the proposed regulations, we examined changes in financial performance for impacts on competitive advantage as well. Based on these findings, EPA set less stringent standards for small foundries in two iron subcategories and granted a complete exemption to magnesium foundries.

One of the major goals of the Act is to encourage agencies to "tier" their regulations, that is, to exempt or to set less stringent requirements for small entities. EPA has issued many regulations that have less stringent requirements for small businesses when the Agency's environmental and health objectives would not be compromised.

In order to comply with the Act's requirement to coordinate its implementation with the Small Business Administration, the Office of Standards and Regulations transmits copies of certifications and RFAs to the SBA.

Public Participation and the Small Business Ombudsman

Under the Administrative Procedure Act, small businesses and other small entities may comment on any EPA rules. EPA also takes special measures to involve small entities in regulations that may affect them.

In early 1982, EPA established the position of Small Business Ombudsman as a subdivision of the Office of Small and Disadvantaged Business Utilization, which is located in the Office of the Administrator. The Ombudsman's primary function is to aid the small business community in its efforts to comply with environmental regulations. Toward this end, the Ombudsman has sought to meld a cooperative working relationship with both the regulated community and key offices throughout the Agency. In particular, the Ombudsman works closely with the Information and Regulatory Systems Division, which often calls on the Ombudsman to support oversight of Regulatory Flexibility Act compliance.

Over the past several years the Ombudsman has built a small business network by pursuing the activities outlined below.

° Through membership in regulatory work groups, the Ombudsman's staff participates in the development of regulations that may have significant impacts on small business. Joining these Agency-wide forums affords the staff the opportunity to communicate the issue-specific concerns of small business directly to regulation writers, while airing their positions before a broad Agency audience.

° By operating the Small Business Hotline, the Ombudsman's office offers the small business community an easy and confidential way to open and sustain the lines of communication with EPA. With a mind toward greater compliance, Hotline staff answer specific questions, help interpret regulatory requirements, and fill orders for EPA documents and reports. (In addition, both our Solid Waste and Toxic Substances Programs have special hotlines that can respond to questions and problems of small businesses.)

° By publishing a brochure that lists over 70 publications on environmental subjects of interest to small business and distributing it to over 7,000 organizations, the Ombudsman's office seeks to achieve greater dissemination of regulatory information; last year alone, the office received requests for more than 10,000 documents. In addition, the Ombudsman circulates an EPA informational update twice a year to roughly 7,000 parties interested in small business environmental issues.

° In a similar way, by issuing Small Business Updates periodically to over 400 managers, the Ombudsman's office attempts to educate and inform EPA personnel about small businesses and their special problems and needs.

In conjunction with the creation of the Small Business Ombudsman, EPA has set up Small Business Liaisons in each program office and region to facilitate and foster communication with the Ombudsman. The Small Business Liaisons often direct inquiries and issues to the Ombudsman's attention.

Conclusion

A major benefit of the Regulatory Flexibility Act is that it has significantly increased the Agency's awareness of and responsiveness to the impacts of its regulations on small entities. In recent years, we have seen legislation such as the Hazardous and Solid Waste Act amendments that limits the exemptions that the Agency can grant for small firms. Although the Agency must give primary consideration to reducing risk to health and the environment, we do pay attention to the special burdens small entities bear in adapting to regulatory requirements. Increasingly, education and technical assistance, as well as other efforts to support compliance, have become important ways of achieving the objectives of the Regulatory Flexibility Act.

Appointment of the Small Business Ombudsman has greatly aided small businesses with their specific problems and will continue to provide a primary mechanism for response to their interests and needs.

This concludes my prepared remarks. I would be happy to respond to any questions you may have.

Mr. SKELTON. As you know, Mr. Ireland had to leave, and he has asked the minority staff to make inquiries at this point. So, I will recognize Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

Could you just briefly explain negotiated rulemaking? What that is and how you use it? Also, I would like to know if you have had any criticism of that? For example, from nonbusiness groups.

Mr. RUSSELL. Negotiated—to answer your first part—negotiated rulemaking is an effort we have instituted under full compliance with our Federal Advisory Committee Act to bring all of the relevant and interested parties together about a particular regulation.

When we identify a regulation or proposed regulation, we attempt to identify each party that is interested, and in some cases, we attempt to bring those parties together to have specific representatives of those parties.

We have a specific charge, that is to say a specific regulation, there to work on, with a specific time limit under which they are to come to some conclusions. We bring them together and ask them, with EPA participation, to come up with a proposal which we would then enter as an Agency proposal.

What the Agency commits to is that if the group, in fact, comes up with a conclusion that is satisfactory to all sides—that is environmental interests and regulated community interests, often we have State participants, often we have other entities—if they, indeed, come up with a conclusion, the Agency will publish that as a proposed rulemaking for public comment.

Then, following that public comment, we can then proceed—if there is no adverse comment—to the final regulation. The result of this is that we get much more information early. We get all of the parties in the room ahead of time. We get much lower probability of litigation about the action, and we find that we can move ahead much more rapidly to adopt the regulation with much lower opportunity or chance of making a mistake.

So, that is regulatory negotiation. It is still in an experimental stage. We have conducted several successfully, and we are conducting more at this time.

In terms of whether there has been opposition, basically, no. There are always a number of parties who are concerned, and what we seek to do is to find regulations that everybody can agree are appropriate regulations. So, there is no criticism in particular of the process.

Mr. LYNCH. Do you know of any other agencies that have tried this or is EPA the only one?

Mr. RUSSELL. There are other agencies who have tried it. The Federal Aviation Administration and others and, in fact, EPA—under work that is being done by some of Ms. Funke's staff, have been seeking to assist other agencies in developing this process.

Mr. LYNCH. Does the ombudsman take part in these meetings?

Mr. RUSSELL. The ombudsman is always open to enter the work groups on all of our regulatory activities. I am not aware if the ombudsman has actually participated in any of these regulatory negotiations or not. Perhaps Ms. Funke could tell us.

Ms. FUNKE. I don't believe so, but I am not sure.

Mr. LYNCH. Who is the ombudsman right now?

Mr. RUSSELL. Karen Brown.

Mr. LYNCH. Thank you. That is all the questions I have. Thank you very much.

Mr. ROBINSON [presiding]. Mr. Russell, I would just like to comment by stating that I am aware that the EPA has a good compliance record, and I commend you and your Agency for that.

Are there any other questions? [No response.]

Mr. RUSSELL. OK. Thank you.

Mr. ROBINSON. I thank you for appearing today.

Our next witness is Carl Pescosolido. Would you come forward, please? I hope I did not butcher your name too much.

You are recognized and you may proceed.

TESTIMONY OF CARL A. PESCOSOLIDO, JR., COOWNER, SEQUOIA ORANGE CO., INC., EXETER, CA

Mr. PESCOSOLIDO. Thank you.

Good morning. I am grateful for this opportunity to explain how my business has been harmed because the agency that regulates my business, USDA's Agricultural Marketing Service [AMS], has ignored its obligations under the Regulatory Flexibility Act.

My name is Carl A. Pescosolido, Jr. I am a coowner of Sequoia Orange Co. Inc. Our company's business is the growing, packing, and marketing of the citrus produced in our own orchards. Our operation represents approximately 1 percent of the California/Arizona citrus industry.

The purpose of my testimony today is to bring to your attention the fact that your passage of the Regulatory Flexibility Act created a paper tiger in all those instances in which agencies refuse to comply with the letter and spirit of the Regulatory Flexibility Act.

SBA has been charged with the responsibility for monitoring compliance with the act, but has absolutely no authority for enforcing its provisions. For that reason, among others, USDA's Agriculture Marketing Service has totally ignored the act. In fact, routinely, each week, regulations are imposed by AMS preceded by a certification in the Federal Register, which states, "[t]his action will not have a significant economic impact on a substantial number of small entities". [51 Fed. Reg. 7245—March 3, 1986.]

I am here to tell you that nothing could be further removed from the truth. AMS knows that its regulations cannot meet the regulatory flexibility test. Therefore, it simply has refused to take that test. Each certification is itself a sham.

Sequoia requested supporting documentation under the Freedom of Information Act, only to find AMS emptyhanded, with nothing of record to support the certification. SBA has, for several years, tried to persuade, cajole, and coerce AMS's bureaucrats to comply, including participation in industry rulemaking hearings and by providing a suggested format for a regulatory flexibility analysis. All to no avail.

To provide insight into the prorate regulations alleged by AMS not to impact small entities, they may be compared to World War II rationing stamps. Each person is told by AMS the exact maximum quantity he may sell each week. This quantity is called a prorate. The system is alleged to result in orderly marketing and equity of opportunity—a socialist scheme so abhorrent that even the Russians 5-year Gosplan rejected it.

There are 3,900 naval orange growers in California and Arizona. These range in size from about 1 acre to about 2,500 acres. There are 27 companies presently marketing these growers' oranges. The largest, Sunkist Growers, Inc., markets about 50 percent. The remainder is divided among 26 marketers, which range in size from about one-tenth of 1 percent to about 4 percent.

Any one who has had a 2-week crash program in basic economics knows that there are economies of scale in any business enterprise. AMS's bureaucrats, however, would have the world believe such economic principles do not apply to the business of growing, packing, and selling citrus. That is absolute nonsense, of course.

It is ironic to note that during the past 5 years, AMS has not imposed prorate controls on about 50 of the 125 packers, nor on about 1,500 of the approximate 3,900 growers. These are the growers and packers from districts 2, 3, and 4. They have been free to sell any quantity of oranges any time, to whom they choose.

Texas and Florida growers and packers, although they sell the same oranges to the same customers, are not subject to any quotas, yet they, too, operate under Federal marketing orders.

My company's orchards and packing facilities are located in district 1. All the while, the most rigid allocation imaginable has throttled our efficiency and has forced us to surrender readily available marketing opportunities to our competitors.

The cost to my company in lost sales since 1979 has been about $6 million. Specifically, our company and other small businesses like us are injured by the prorate limits in several ways:

First, we are bound by an absolute limit on weekly and seasonal sales, regardless of our marketing opportunity and fruit quality.

Second, we are unable to stimulate sales beyond our weekly quotas to promote sales programs with regular or new customers.

Third, our export sales are restricted because of the domestic controls which do not allow us to sell the surplus sizes and grades not required by our export customers.

Fourth, our ability to innovate is stifled because no economic reward can be earned from investment in new or more efficient technology since no additional sales can be made under the quota system.

An example is the shrinkwrap technology that permits the long-term sanitary preservation of citrus fruit.

In addition to the injuries described above, the prorate regulations harm my company because of our small size relative to Sunkist. For example, the total pool of prorate available to Sunkist can be moved among its 75 member packing houses in order to meet their individual needs.

Also, Sunkist is assured of getting additional prorate, for example, to meet promotional commitments, because of its control of the industry committee that recommends the level of weekly quotas to AMS.

As a small independent, I have no chance to obtain an increase in the weekly prorate. AMS's noncompliance with the provisions of regulatory flexibility is not only contrary to law, it is also unconscionable. The harmful economic effects could not have occurred had AMS complied with regulatory flexibility.

You might well ask, what motivates AMS to ignore regulatory flexibility? It is my view that there are three primary motivations.

First, preservation of the status quo.

Second, adherence to the belief that AMS should set policy consistent only with the objectives of the largest dominant entity in each agricultural commodity it regulates.

Third, protection of job security at 14th and Independence Avenues.

Prorate regulation, if subjected to objective analysis of its differential economic impact would both flunk the test of value and cease to serve these three objectives. Failure to conduct the required analysis is ironic because, to my knowledge, no agency has a greater data base and no agency has more economists.

AMS has never developed any criteria to evaluate the burdens and benefits of its prorate regulations. What greater burden is there to a grower than to be denied the right to sell what he has produced? For example, in many years, we are forced to destroy up to 75 percent of our lemons.

What greater burden is there to a marketer than to be denied the right to sell to a willing customer? Worse yet, be forced to surrender orders from his customers to his competitors.

AMS would have us believe this is the American way. That American way turns the American dream into a nightmare in which my largest competitors control my ability to sell what I have produced on my own land and for which I have willing customers.

AMS states that regulatory flexibility does not apply to its weekly decisions to approve prorate regulations. The very threshold decision to regulate at all has immense economic consequences.

For example, many of my competitors would be unable to sell 25 percent or more of their production without the crutch of Government regulations. Their problem, in my opinion, is inefficiency. My company can sell all of its merchantable production. AMS is sponsoring inefficiency and knows it. It refuses to perform the analysis which will reveal its support of wasteful, burdensome, unnecessary economic regulation of farmers.

Every study done by every economist or agency, other than AMS, both inside and outside USDA, confirms the waste and abuse under this program.

USDA says the marketing orders are voted on by the citrus industry. That is somehow supposed to alleviate the need for analysis of their economic effect.

In the California/Arizona citrus industry, Sunkist has the power to block vote [that is, its board can cast a single ballot for all its members, more than 50 percent of the industry by number, but less than 50 percent by volume]. Therefore, the outcome is predetermined. What Sunkist wants from AMS, Sunkist gets.

There is never an opportunity for individual growers to decide whether AMS's approval of prorate is in their best economic interest. In fact, AMS's refusal to perform the initial regulatory flexibility analysis and the final regulatory flexibility analysis is intended to ensure that growers remain uninformed of the real consequences of regulations and of their massive differential impacts.

There has never been a meaningful, substantive review of the so-called annual marketing policies. These are routinely rubber-stamped by AMS. If supply controls are so beneficial to growers and consumers, it seems to me that AMS should want to tout its wonderous regulatory scheme for all the world to praise—not hide the results behind the facade of bureaucratic benevolence by certifying these regulations to have no significant economic consequences to those regulated. Of course, if there are no economic consequences, then why regulate?

No bureaucrat at AMS has ever been able to answer a single question. Tell me how my economic welfare is improved by your making it illegal for me to sell the products of my labor? Or a second question: Why am I better off being forced to surrender orders for my citrus to my largest competitor just because he has been too inept or otherwise incapable of earning the order, absent the coercive regulation which creates for Sunkist the protected marketplace?

AMS states that there is no requirement for regulatory flexibility analysis because marketing orders are promulgated after formal rulemaking hearings. The law provides no exceptions for this, or any other reason, even in the case of published rules.

To illustrate the utter absurdity of AMS's position, there was a 6-week rulemaking hearing on lemons more than 2 years ago. Not only did AMS fail to provide any analysis whatsoever at the hearing, but also, at the time of publication of the recommended decision, there was still no analysis, despite the extensive testimony by many small business witnesses concerning the short- and long-term harmful effects of prorate. To this date, no final decision has been rendered.

The most recent rulemaking hearings to amend the navel and valencia marketing orders occurred in 1983. The primary substantive issue of record was the negative economic consequence of prorate regulation. When AMS published its decision, the more than 2,000 pages of testimony and exhibits, which proved that prorate is an economic disaster for growers and consumers, were totally ignored.

AMS did no analysis whatsoever. Rather, it ignored the record. What are growers supposed to do about that?

For more than 50 years AMS has asserted that orderly marketing of California's citrus is beneficial to consumers and producers.

This reminds me of Congress' concern in 1933 that the passage of the original Agricultural Adjustment Act would provide a temporary safety net, and not, either through abuse or abdication of delegated authority, become a long-term experiment with socialized agriculture.

Tell a big lie long enough, and the unthinking will come to believe it. That is exactly the kind of unthinking that the Regulatory Flexibility Act is intended to undo.

There is a problem. No one has ever been able to define orderly marketing. Even USDA's former Assistant Secretary for marketing, Mr. C.W. McMillian, when he testified last October at a hearing, stated: "I have no idea what that is. I have never heard anyone define orderly marketing." Even, were there to be an adequate definition for this purposefully vague term, it is AMS's lawful obligation to then demonstrate that the burdens are outweighed by the benefits of orderly marketing, and further, that the benefits are not skewed to benefit the largest company in the business, Sunkist. I am not the only person to complain about AMS's refusal to comply with the Regulatory Flexibility Act, its refusal to analyze its regulations, and its inability to define the catchwords intended to rationalize its rubber-stamping or prorate regulations.

The coalition of growers, packers and marketers, called Agriculture for Market-Oriented Policies [AGMOP], represents 25 to 30 percent of the California/Arizona navel orange business. They are all strong advocates of reform.

GAO, SBA, FTC, until muzzled by a Sunkist-sponsored appropriation rider, DOJ, OMB, until muzzled by a Sunkist-sponsored appropriation rider, and the Cabinet, have strongly criticized AMS's prorate regulations.

To this day, AMS continues to refuse to analyze economic consequences of these regulations. It is clear to me that by passing the Regulatory Flexibility Act, Congress intended to correct abuses, such as AMS's irresponsible rubber-stamping of needless, burdensome and wasteful regulation. It intended that SBA would exercise meaningful oversight and that a willing AMS would voluntarily conduct a self-analysis. That is Utopian. Congress did not simultaneously delegate necessary compliance tools. Therefore, you are faced with two choices, among others.

Revise the Regulatory Flexibility Act in such a manner as to make AMS accountable directly to Congress, or provide SBA, DOJ or another agency with the necessary tools to force AMS to carry out both the letter and spirit of the law. AMS has routinely circumvented Congress and frustrated the intent of the Regulatory Flexibility Act by its certification.

If that is what you intended, then just vote to sunset the whole act and stop the charade. Meanwhile, I will continue to watch you like a hawk because I know that the only beneficiaries of AMS's supply controls are the largest and least efficient packers and marketers. That, I sense, is AMS's version of the American dream. To the inefficient go the rewards of overregulation.

I want to see an end to the Government-sponsored cartel that regularly takes my private property without benefit to either me or the public. It is my belief that AMS's compliance with regulatory flexibility, the truth in Government statute, will speed this result.

I want to thank the subcommittee for its interest in seeking full compliance with the promises of the Regulatory Flexibility Act.

Thank you.

Mr. ROBINSON. Thank you.

I would like to first recognize Steve Lynch with the minority staff to see if he has any questions.

Mr. LYNCH. Thank you, Mr. Chairman.

Just some questions, first, because quite a bit of this is confusing to me.

Page 3 of your statement, you note that in the past 5 years, several of the districts, I guess, have been exempt from the prorate control, is that correct?

Mr. PESCOSOLIDO. That is correct.

Mr. LYNCH. Is there a reason why or has Agriculture ever given a reason why that is? Why some are covered and some are not?

Mr. PESCOSOLIDO. No; my understanding is that the committee that makes the recommendations to the Department of Agriculture recommended this because those districts are smaller than our district.

For example, in the navel oranges, those three districts that have not been regulated have perhaps 17 percent of the production, and our district perhaps has 83. I think, in effect, it is some sort of a tacit recognition that because they are smaller, less important, they do not need regulation. Therefore, they are free to do whatever they want. Simultaneously, our district is treated in the opposite way.

I think it is an irrational explanation, but I believe that is the answer to your question.

Mr. LYNCH. Suppose someone, such as yourself, just said I am fed up with all this and I am going to sell my whole product, I could care less, what would happen then?

Mr. PESCOSOLIDO. The orange committee compliance officers would come to my place of business and, indeed, they have, I would add, and would make known what are called the overshipments, beyond the quotas, to the Department of Justice, and if it were proved that I had done that or my company had done that, I would be fined or imprisoned or both.

Mr. LYNCH. Has that happened in the history of all this? Has the Department of Justice gone after them?

Mr. PESCOSOLIDO. Yes, sir.

Mr. LYNCH. And, what was the result of that?

Mr. PESCOSOLIDO. I know of several specific instances where there were severe fines imposed. I do not know of any instance where anyone was imprisoned.

Mr. LYNCH. And, I assume they make the fines large enough so that it is not worth someone's effort to do it?

Mr. PESCOSOLIDO. There is——

Mr. LYNCH. Even if you sold your product, you would lose it in the fine scheme.

Mr. PESCOSOLIDO. That is, in essence, correct. They are equal to what is called the FOB value of the shipment, 100 percent of that value.

Mr. LYNCH. It is my understanding that some oranges really are only sold as eating oranges whereas other oranges are sold for orange juice production because of the different types of oranges. One, I guess is better for the other.

Is that true, and if that is true, is that part of the decisionmaking process for someone who has groves? In other words, would that have anything to do with how much they are allowed to sell?

Mr. PESCOSOLIDO. The answer to your last question, first, is that that would have no reason whatsoever to do with what they have to sell. The quotas are based on quantity that each packer——

Mr. LYNCH. It has nothing to do——

Mr. PESCOSOLIDO. It has nothing to do with their quality. The answer to your first question is that in California, we are proud of the fact that we have a seedless navel orange, and it is almost entirely developed for out of hand eating, unlike the Florida, for example, which is primarily a juice orange.

So, the answer to your question is that it is my intent as a grower to produce all of my fruit for the domestic—what is called the domestic fresh market or the export market, and I would add very quickly that if I am forced to deliver my navel oranges to byproducts, juices, the costs of my harvesting are not even equaled by the revenue. Therefore, it is an outright dead loss if I deliver any oranges to byproducts, juice.

Under these regulations, I am forced to deliver very, very large quantities that I could otherwise sell.

Mr. LYNCH. That is all for the moment, Mr. Chairman. Thank you.

Mr. ROBINSON. I would like to thank you also. You made a very clear, logical presentation. Your remarks will become part of the record. Thank you for appearing today.

Mr. PESCOSOLIDO. Thank you.

Mr. ROBINSON. Our next witness is Mr. John Franke, Jr., Assistant Secretary for Administration, USDA.

Good morning.

TESTIMONY OF JOHN J. FRANKE, JR., ASSISTANT SECRETARY FOR ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. **Franke**. Good morning. I am hopeful the committee has my written testimony before it.

Mr. **Robinson**. We do, yes.

Mr. **Franke**. And, I would merely like to highlight certain sections of that, if that is agreeable.

Mr. **Robinson**. Without objection, so ordered.

Mr. **Franke**. I feel it appropriate to bring to the committee's attention the size and scope of the Department of Agriculture and in the spirit and the intent in which we are following the act and other statutory requirements for the Department.

Depending on the season, the Department of Agriculture employs anywhere from 100,000 to 120,000 individuals. We maintain 17,000 offices around the world, and we are a large organization, comprised of 43 agencies and staff offices running from the Forest Service, among one of our larger agencies, to small agencies for various service functions.

To get an opportunity to appear before the committee and in my role and position, I feel is a benefit. One of the difficulties in a large organization, such as the Department of Agriculture, is communicating on the same level with the same semantics and same meanings and the verbage and those sorts of things. I do appreciate this. We do not get a chance to toot our horn, so to speak.

Before I came to Washington, about 4 years ago, I was a local official for quite some years, county commissioner, mayor, and things of that nature in the Kansas City area. Before that, I was in small business, and at that time, 10 years ago or more, we were not large enough to qualify for Small Business Administration programs.

There is a certain size, I think, that you have to become in a small business before you can qualify for small business programs. So, I will attempt to keep some of those thoughts in the back of my mind as we address and implement and follow the spirit and intent of the act.

The efforts that we follow in Agriculture, and I am, for purposes of small business activity, the deputy to the Secretary, the small business office or the small and disadvantaged business office, and those sorts of policies flow out of my office. However, each of the agencies, the 43 agencies and offices within Agriculture, each have their own small and disadvantaged business utilization coordinator.

It is a complex organization that we attempt to control by directives. The spirit that I have found in Agriculture and particularly with regard to small business, agrees with my own personal philosophy and certainly that of the Secretary, that that is an integral part of our Nation, that there are numerous taxes and a great deal of employment comes out of the small business community. So, we subscribe to both the spirit and the intent of the various small business acts and certainly, in my own case, as a local official and a businessman for a period of time, regulatory flexibility, paperwork reduction, any of those acts could make life miserable for truly small businesses that spend a lot of time worrying on Friday night whether a payroll check is going to clear on Monday.

We have been through that. In Agriculture, we are concerned and we are aware of the act and the implementation, and, in fact, some of the other acts that have come about—the Paperwork Reduction Act in addition to the Regulatory Flexibility Act. We have had an early start in understanding that a free and open communication with small business, local government and State government and those such things that are a necessity for a large department. So we can keep the pulse of the Nation as much as possible, and most of Agriculture's activities and most of our business deals with small business, small farmers, the producers, those grassroot things that you may deal with agriculture. We look upon ourselves as the peoples Department, and I do not say that lightly.

So, building communication and building that open spirit of communication is very important to us. We began with the understanding, the diversity, the competition, the balance and the opportunity that is possible in agriculture because we are large, we spend a lot of money, and we affect a lot of production, and we are an enormous portion of the gross national product. Agriculture itself is an industry.

We believe that advance contacts are very essential in any kind of a discussion—advance meetings with small business, with the business community, local government. I served for about a year with the Environmental Protection Agency as a regional administrator in Kansas City, and they probably have one of the more difficult jobs of establishing good communication with the business community and the small business community and yet not running afoul of conflict of interest.

I felt the Kansas City region was quite successful, and that spirit remains. We cannot do those things out of Washington. Our field managers must be responsible, and in Agriculture, we feel they are. We have early meetings. We established interim guidelines in 1980. The Secretary, in 1981, took an action through the directive system to bring together many elements of the Regulatory Flexibility Act and the Paperwork Reduction Act, those sorts of things. Our style is to institutionalize, to make certain that not only Washington officials but the field officials and the people that deal directly with the community, small business and with other facets of our community and society, understand that communication is inherent, that we do these things automatically.

We understand from previous testimony marketing orders are of interest. Unfortunately, I am not directly familiar with marketing orders. It is a very complex subject. However, I would like to address a few examples that we use within the Department of Agriculture through our agencies and offices and some of the methods we use to implement both the spirit and the intent of the Regulatory Flexibility Act, plus other things, like the Paperwork Reduction Act. The letter of invitation indicated that other things are of interest, where we may have seen benefits from the act, and problems. There are some problems when you deal with statutory activity.

We spent a little time in 1981 in defining the word small. We accepted SBA's definition of the words small business. We do that, also, certainly, when we try to define large farming, small farming, a family farm, things of that nature, and like the Congress, I am sure you spend a great deal of time on defining what is meant.

We hope to not only carry through, and we feel we are carrying through the letter of the law, but the spirit and the intent, and I probably keep mentioning that, but we did not wait. We moved ahead of what OMB, SBA, other entities were moving on, when we heard about the act and how the act should be implemented. We performed what we call a consolidated process, and in the information we sent over we included the directive, the departmental directive of 1983, that brings together a process, an internal management process, and which brings together two or three elements of an act that it is meant to communicate.

Another factor that is not mentioned often in hearings such as this, is that in the Federal Government we impose a great deal on ourselves as far as information collection and paperwork requirements.

We also attempt to address in other ways the imposition of paperwork activity and many times, make work on our own offices and agencies and our field offices. The need for paperwork reduction in our estimation is a great part of this, I believe. The imposition of the burden on the public and on our own work force, that determine to run formal analyses, in many cases, are many times conflicting with the paperwork reduction requirements.

Many, only in the managerial field ever realize and understand that. In attempting to do good on this hand and the methods you use force an imposition on the other hand. We have tried to combine many of those things and many of those approaches, and still follow the law itself.

We have reviewed the system in 1983, that was established in 1981. I did a little bit of tinkering with it perhaps to make it more effective, relying principally on our interpretations, knowing we serve several publics within agriculture and many times, several conflicting publics within agriculture, trying to achieve some sort of balance, and yet follow the spirit of equity and, certainly, follow the reason for our existence as the Department of Agriculture.

We attempt to amend our systems to fit the programs as opposed to recommending programs that fit the system. We feel, within recent years, with our electronic capabilities we can do that much more effectively. We know that circumstances change, and we know that the methods of operation change. We use technology and not only new technology, but things like telephone and interstate highway systems are considered, in many cases, new technology in some agricultural areas.

So, we have attempted. We may not be perfect, in addressing 43 agencies and offices doing those sorts of things and attempting to communicate effectively and take advantage of what we see as an opportunity for flexibility and paperwork reduction to not only remove burdens from businessmen and Federal officials, but from our own employees and our own work offices and field offices.

Some examples in labeling actions—I will not go through the two or three examples we have here, fully but, we were petitioned by industry to revise the standards for meat pizza and labeling requirements for meat and poultry products and cheese substitutes.

That is a major issue in agriculture, substitution of this or that and the labeling question.

The regulatory activity was known to us as the revised pizza regulation, and within Agriculture, it is a very serious question. The rule could potentially have a very significant impact on a number of small businesses, and we understand that, from the close contacts we have with businesses.

So, we extended the comment period. We went out of our way, in effect, to learn that a proposed rule or regulation could have an effect on small business and it could have an effect on the community. We informed our field employees so that anyone who is aware or wishes to be made aware, could ask our field employees within the food safety inspection service. They could answer questions on the spot or in the field, whether it is small business, large business, local community, whatever it may be.

We attempted to ensure that all small entities were personally informed that they could be affected. We received 6,000 comments and the net effect was that we went out of our way to inform over and above any analysis required or demanded or indicated by the act.

We sent teams of technical personnel in the field to events in areas, such as Puerto Rico, that perhaps have a large Spanish-speaking population, so we ensure that translators are available, people able to speak Spanish, and that there are signs in local languages there.

We hold hearings, meetings. We attempt to go over and above the formal requirement of the act and the law, and we attempt to communicate more effectively. We extend time where possible and where needed.

So, I will not go through all the examples we have and we use Mr. Chairman, but I think our front end communication with small entities is a very essential part of the way we do business in agriculture, and the way we intend to and the way we do follow the purposes of the act.

Marketing agreements and orders have been mentioned by others preceding me, and there is a difference of opinion between the Small Business Administration Advocate, who, in fact, is appearing in Agriculture right now at our request, to visit with our small business offices, and indicating ways and methods in which communication with SBA may be brought closer.

The producers and handlers of fruits and vegetables, and specialty crops, and milk, and things that come under the marketing agreements and orders that are administered by the Agricultural Marketing Service, are small entities. They are, indeed, small entities. None of these programs can be put into effect, however, unless they are approved by a substantial number of the affected entities.

The committees that are mentioned are production committees. They have a say. They can influence the input and the output of what is approached by Agriculture.

This is in addition to following all the public participation requirements for formal and informal rulemaking. The programs must be terminated if the majority of the producers so desire. The administrative bodies that run these programs typically include representation of small entities, and there is a great deal of clout given. I could mention others. We believe and we are convinced that the Regulatory Flexibility Act has helped focus attention on the specific concerns of small entities because we do have an interest.

The act itself, in my opinion and in the opinion of the Secretary, has actually helped us take our concerns in other areas for small entities and small business and certainly local government activities also.

The benefits of the act itself and our implementation of the act gives us a hand, to better recognize the small business problems and the small business contribution around the Nation.

The problem, as in any piece of legislation, or statute, or act, or effort we are about, is there are varying interpretations, and there is difficulty in those differences. There will certainly be differences on how this act affects each agency and each bureau within the Federal Government, let alone Agriculture, and there are those differences.

There are differences in definitions and differences in interpretations. However, the bottom line and the pluses of the act outweigh those problems that develop. We will certainly have a dialogue with SBA, and we may disagree. I will certainly have a discussion. We do have ongoing discussions with small producers and large producers that make up this thing we call United States and American agriculture.

The bottom line is there is a system to resolve those differences, both with this committee, the Congress, and with the Department. Differences will come in anything that is important, and there are differences, and we understand it.

Mr. Chairman, I stand ready to answer any questions or respond in any fashion I may.

[Mr. Franke's prepared statement, with exhibits, follows:]

PREPARED STATEMENT OF JOHN J. FRANKE, JR., ASSISTANT SECRETARY FOR ADMINISTRATION, USDA

Mr. Skelton and Members of the Subcommittee: I appreciate the opportunity to discuss with you our efforts to assist small business and the Department of Agriculture's success in implementing the Regulatory Flexibility Act of 1980. I will describe what we have done to implement the Act, and provide several examples so that you can see how the Act has fostered detailed reviews of regulations under development and an analysis of how they might affect small businesses.

Early Implementation Activities

As you know the Department of Agriculture, like the Small Business Administration, is concerned with diversity, competition, balance and individual opportunity in our economy. In fact, from its very beginning Departmental programs have tended to be specifically targeted at assisting the small and medium sized producer and other small entities. We were pleased when P.L. 96-354 was signed into law on September 19,1980, because it would add impetus to our efforts to assist small entities.

The Small Business Administration and the Office of Management and Budget began almost immediately to develop an implementation strategy. To help assure the early and effective implementation of the Act, USDA officials participated in this informal development period.

Implementation activities at USDA, however, began even before formal SBA and OMB guidance was completed. This early start made it possible for program coordinators to consult with organizational entities within USDA as to how best to implement the new initiative. Experience has shown that advance consultations with affected entities helps eliminate problems in implementing any initiative. Advanced consultations also helps build individual commitment to the overall team goal. Since the Act required regulatory decisionmakers in all sorts of different disciplines to put additional emphasis on helping small entities, decisionmaker involvement up front was a key part of USDA's implementation.

Guidelines Were Implemented

When USDA's interim guidelines were issued December 31, 1980, regulatory coordinators met with decisionmakers at all levels to explain the implementation to them. This personal approach also made it possible to encourage comments on the guidelines, to help decisionmakers find ways to make consideration of small entity effects an integral part of existing regulatory analysis and development activity, and to iron out any early implementational problems. We have attached a copy of this directive for your information, see Exhibit A.

The directive established that Regulatory Flexibility Act activity should be woven into the fabric of regulatory development procedures. Specifically:

- Agency heads would look at effects on small entities when they first raise the plans for a regulation with their Assistant or Under Secretary.

- Agency heads would review the need to define "small entity" more specifically than existing regulations and follow public process to establish appropriate definitions if needed.

- Review plans would be established to assure that small entity impact was looked at for all USDA regulations within five years (the Act requires review every 10 years).

- Actions subject to the Regulatory Flexibility Analysis would be included on the Department's semi-annual Regulatory Agenda. In addition to the regulatory flexibility items, only major and certain other regulations are included in the Agenda, so it is easy for the public to identify Regulatory Flexibility actions of interest to them. Agendas would be provided to the Small Business Administration and directly to small entities, as appropriate.

- Regulatory Flexibility Analyses would be completed as an integral part of the normal analytic process on actions the Agency Head felt could have "a significant economic impact on a substantial number of small entities." The SBA was advised of all actions for which such analysis was unnecessary.

The agencies of the Department proceeded to immediately implement these guidelines. Much effort was focused initially on the adequacy of SBA's existing definitions of "small." However, over time, each organization determined that the existing Small Business Administration definitions worked fine. Such agency level implementing procedures as were necessary were promulgated, and the Act went into full effect.

Regulatory Development Procedures Consolidated

In June of 1981 the Secretary issued a directive implementing a single regulatory development process which encompassed both Executive Order 12291 and Regulatory Flexibility Act requirements. The procedures described above were included in that directive, side by side with those needed to implement the Executive Order. I have attached a copy of this document as Exhibit B to my written testimony.

December 15, 1983, the Secretary completed a review of the system and signed a new directive maintaining the consolidated system approach and continuing most of the procedures essentially unchanged. These procedures have worked well for the Department, and continue to this day. I have attached a copy of this document as Exhibit C.

Now I would like to go on and discuss some examples of activities completed under the Act.

Examples of Regulatory Flexibility Actions

So that you will understand the analytic methods used, the types of data and how we identify alternatives, I would like to present to you four sample actions we have done in recent years. Individually these may not be big, impressive sounding actions. However, they illustrate some basic issues that we deal with day to day that tend to go unnoticed. Each of the four items is from USDA's marketing programs because these agencies tend to deal with lots of small farms and businesses.

Labeling Action

We were petitioned by industry to revise the standard for meat pizza and the labeling requirements for meat and poultry products with cheese substitutes. This regulatory activity is known to us as the "Revised Pizza Regulation." On July 18, 1983, the Administrator of the Food Safety and Inspection Service (FSIS) determined that the proposed rule could potentially have a significant impact on a substantial number of small businesses. The Agency prepared an Initial Regulatory Flexibility Analysis in conformance with the Regulatory Flexibility Act (RFA) of 1980 (Public Law 96-354). The proposed rule was published on August 5, 1983. The Agency extended the comment period on this proposal six months until March 2, 1984. This allowed small and large entities in the affected industry the opportunity to study the issues carefully and comment fully.

The Agency also informed all field employees about the proposal through the FSIS employee newsletter. FSIS inspectors are in the affected plants on a daily basis could ensure that all small entities were personally informed of the proposed rulemaking. All entities affected, whether large or small, are visited by inspectors so specific targetting was not needed.

Ultimately 6,000 comments were received on this proposal. None referred specifically to problems that the rule might create for small entities. However, after applying the Regulatory Flexibility Analytic requirements, it became clear that differential impact on small entities was not a problem. We regard this as a success for the Regulatory Flexibility system. The system caused us to scrutinize our proposal more carefully than we might have otherwise, to try to assure that provisions would not hurt small entities.

Control of Added Substances

Another example from the Food Safety and Inspection Service pertains to the rule titled "Control of Added Substances and Labeling Requirements for Cured Pork Products; Updating of Provisions." The Agency recognized that this proposal was highly technical and could easily confuse affected entities. To help explain the complex proposal and eliminate the confusion, after publishing the rule on November 10, 1982, FSIS held meetings with industry representatives.

The Agency sent a team of four technical personnel to each of these meetings to answer questions and explain the proposal's provisions. The meetings were held in five different states (Illinois, Indiana, Tennessee, Florida and California) to maximize public participation in the rulemaking. Bringing the meetings closer to the entities affected is particularly advantageous to small entities since they are less able to afford travel to distant locations to participate.

The Agency also held similar meetings with its own field personnel so that these employees were better equipped to respond to industry questions. "Q's and A's" were prepared and distributed at affected establishments nationwide. As a result, all entities affected, including the small ones, were able to get first hand information from field personnel on this rulemaking. Further, FSIS was able to get first hand information on how it would affect all levels of the industry.

The very nature of these efforts improved the chances of effective participation for small entities proportionately greater than for larger organizations. The larger organizations tend to already have the financial flexibility to be able to keep informed and to participate. At least in part due to these efforts, small entities understood the proposal and no problems were identified in that area.

The action was published final on April 13, 1984, with over one year allowed before it became effective. The extra year, ordinarily an action is effective in 30 days, was particularly helpful for smaller establishments since it allowed them plenty of time to adjust levels and procedures to comply. Once again, the Regulatory Flexibility Act registered a success. It fostered an environment where effects on small entities were considered up front, issues were communicated to small entities, and problems were averted.

Swine Health Protection

Another example is the Swine Health Protection rulemaking published in the Federal Register by the Animal and Plant Health Inspection Service (APHIS) April 16, 1982, as a proposal. The proposal implemented the new Swine Health Protection Act by addressing the handling and treatment of garbage to be fed to swine. Unless treated properly, garbage could transmit various infections or communicable diseases to swine with disastrous results to industry and the consumer.

The proposal specifically called attention to the fact that 95 to 99 percent of the premises producing swine could be considered small entities. In order to address the issue of the impact on these small entities, an Initial Regulatory Flexibility Analysis was prepared and its availability announced in the notice of proposed rulemaking. The analysis showed that only a small percentage (1.4 percent) of the premises fed garbage to the swine. Since these premises would be the only ones affected by the regulation and since many of those were already regulated by State regulations, it was subsequently determined that there would not be a significant impact on a substantial number of small entities.

Before that determination was made, however, a special effort was mounted to make individual contact with garbage feeders in Puerto Rico since more than half of the known garbage feeders are located in that Commonwealth.

Approximately 3,000 garbage feeding premises are located in Puerto Rico. All of these are visited on a monthly basis by either Federal or Commonwealth employees for compliance inspections. During these visits the proposed regulations were discussed in Spanish. Messages were left for those garbage feeders not present when the inspection was performed. These messages were also in Spanish and translation services were made available to those who wished to read the proposed regulation. Press releases were distributed to the media in the continental United States as well as in Puerto Rico. Particular emphasis was placed on getting the release placed in the journals most likely to be read by swine producers. In Puerto Rico, the release was translated into Spanish with material added to the release explaining where the public could go locally to get personalized information.

Except for the special emphasis on Puerto Rico, a standard list of industry contacts was used to distribute the press release and copies of the proposed rule. Approximately 2,000 copies of the proposal itself were mailed out to industry groups, both pro and con. Fourteen major associations, representing almost all producers in the swine industry (most of whom are small), commented favorably on the regulation. After due consideration, the final regulation was published on November 3, 1982. The regulation established treatment procedures for garbage, feeding procedures, and various procedures for separation of the animals and the feed. Thanks to the front-end communication with small entities, the rule went smoothly into effect two months later.

Swine Health Protection; Rendering

As a follow-on to final regulatory action published November 3, 1982, as discussed above, an exemption was promulgated May 18, 1983. After continuing review APHIS determined that the rendering facilities for garbage to be fed to swine did not need to be subject to the Swine Health Protection regulations. Accordingly, the facilities were exempted. Although the impact was not "significant", this action clearly benefits small entities proportionately greater than larger ones.

Special Procedures Encouraging Participation of Small Entities in Rulemakings

The Department has various regulatory programs called marketing agreements and orders which assist producers and handlers of fruits, vegetables, specialty crops and milk. These are administered by the Agricultural Marketing Service. Most of the producers and handlers who are affected by these programs are small entities. None of these programs can be put into effect unless approved by a substantial number of the affected entities. This is in addition to following all of the public participation requirements for formal and informal rulemaking. Also, the programs must be terminated if a majority of the producers so desire. Further, the administrative bodies that run these programs typically include representation from small entities. This gives small entities considerable clout in shaping program regulations to minimize the burden on their operations.

The Animal and Plant Health Inspection Service (APHIS) implements regulations to eradicate diseases and pests that affect animals and plants, and for animal and plant export/import quarantine programs. APHIS also regulates the manufacture of biological products used in the treatment of animals and it administers regulations for humane handling and transportation of animals. As a consequence, APHIS has used cooperation with various associations of small entities to disseminate and gather information on its rulemaking. This has helped assure that small entities in each affected field were notified of regulatory issues under consideration. Individual entities can either direct their comments and information directly to APHIS or through their association to APHIS.

Overall we believe that the Regulatory Flexibility Act has helped focus attention on the specific concerns of small entities and helped us take their concerns into account before problems arise. We have no recommendations for further change in the law.

* * * * * * *

I want to thank you for your interest in our efforts to improve the management of the Department's regulatory development system and its particular attention to assuring that proper attention is given to consideration of the impact of our action on small entities. If you have further questions, I welcome the opportunity to answer them.

Exhibit A

Interim Guidelines
December 31, 1980

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

December 31, 1980

SUBJECT: Regulatory Flexibility Act: Responsibility for Implementation

TO: Agency Administrators

The Regulatory Flexibility Act, P.L. 96-354, was signed into law on September 19, 1980. The basic purpose of the Act is to ensure that agencies endeavor to fit regulatory and informational requirements to the size and nature of the businesses, organizations and governmental jurisdictions subject to regulation. It grew out of a concern that unduly burdensome requirements were being placed on the small business sector as a result of federal government regulations, thereby hindering competition.

The Regulatory Flexibility Act contains elements similar to those contained in Executive Order 12044, implemented in this Department by Secretary's Memorandum 1955. For example, it requires a regulatory flexibility agenda, initial and final regulatory flexibility analyses of rules affecting a substantial number of small entities, increased public participation, and a schedule for reviewing all existing and future rules impacting on small entities. It becomes effective on January 1, 1981.

The Departmental Decision System Staff, located within the Office of Budget, Planning and Evaluation, has the responsibility for carrying out the directives found in Secretary's Memorandum 1955. Thus, I am assigning responsibility for the issuance of guidelines implementing the Regulatory Flexibility Act, in conjunction with procedures already established by the Departmental Decision System, to Dr. Linley E. Juers. Dr. Juers has been designated the Regulatory Flexibility official for the Department and will issue those guidelines shortly. Should you need information on this matter prior to receipt of the guidelines, Dr. Juers may be reached at Ext. 76667.

Howard W. Hjort
HOWARD W. HJORT
Director, Economics, Policy
Analysis and Budget

cc: Agency Decision System Contacts

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

OFFICE OF BUDGET, PLANNING AND EVALUATION

December 31, 1980

SUBJECT: Regulatory Flexibility Act: Guidelines and Instructions

TO: USDA Agency Heads

Attached is a set of interim guidelines for the implementation of the Regulatory Flexibility Act (P.L. 96-354) which becomes effective January 1, 1981 and which will affect all regulations proposed after that date.

The requirements of this Act are similar to the procedures established under Executive Order 12044 and Secretary's Memorandum 1955 but are focused specifically on the impact of regulations on small business, small organizations and small governmental jurisdictions. These guidelines attempt to merge the new requirements of the Act with our existing procedures, but certain new elements are required. Regulatory actions with significant economic impact on a substantial number of small entities must be so designated in the Decision Calendar, the various small entities must be defined, the impact of the regulatory action on small entities must be specifically addressed in the analyses, exemptions from the regulatory flexibility analysis requirement must be certified by the Department and notification must be provided to the Chief Counsel for Advocacy at SBA of any exemption or initial analysis.

There will be some differences in the way this Act affects each agency, particularly in defining small entities and determining what constitutes significant economic impact and substantial number of small entities.

Thus, while these guidelines should be put into effect immediately, to meet the effective date of the law, they are subject to revision over the next month or so. I would appreciate receiving your agency's comments by January 30, 1981 on how these guidelines might be made more specific or on any changes needed to accommodate particular problems.

We also need to identify a Regulatory Flexibility contact for each USDA agency to work with both our office and SBA. For the time being, we will presume that your present Decision System coordinator will serve in that capacity unless we are advised otherwise.

Sincerely,

Linley E. Juers

LINLEY E. JUERS
Associate Director
Decision System

Enclosures (2)
1. P.L. 96-354
2. Guidelines

cc: Decision System Coordinators

Regulatory Flexibility Act

Guidelines and Instructions

The "Regulatory Flexibility Act" (P.L. 96-354), to ensure that regulatory and information requirements are tailored to the size and nature of small businesses, small organizations, and small governmental jurisdictions, was signed into law on September 19, 1980 and becomes effective on January 1, 1981. P.L. 96-354 seeks to ensure that all regulations having a significant economic impact on a substantial number of small entities, use flexible alternatives to achieve their goals by requiring agencies to solicit and consider flexible regulatory proposals—including de minimis exemptions, variations in reporting or compliance standards, and variations in compliance timetables, for example—and to explain the rationale for their actions so as to assure serious consideration of those alternatives.

The Act bestows significant implementational responsibilities on the Office of Advocacy of the Small Business Administration. The Office of the Chief Counsel for Advocacy at the Small Business Administration is responsible for the administration of P.L. 96-354, and the Office of Management and Budget will be monitoring the Department's compliance with the Act. Both SBA and OMB have devised guidelines for the implementation of regulatory flexibility in rules affecting small entities. This memo serves to combine those guidelines and integrate them with the existing operational instructions which govern the Decision System. The Decision System was designed to carry out the directives contained in Secretary's Memorandum 1955, written to implement within USDA the requirements of Executive Order 12044.

This office has attempted to mesh the requirements of the Regulatory Flexibility Act and those of E. O. 12044 as tightly as possible, so as to eliminate unnecessary duplication, in view of the fact that the basic elements of the two documents are similar (e.g., a regulatory agenda, initial and final impact analyses, increased public participation, and periodic review of existing regulations).

Each of these elements and guidance as to implementation are set forth in detail below:

COVERAGE

The Act applies to all rules for which a notice of proposed rulemaking is issued on or after January 1, 1981 and which will have a significant economic impact on a substantial number of small entities.

The term "rule" means any rule, for which the agency publishes a notice of proposed rulemaking pursuant to Section 553(b) of the Administrative Procedure Act or any other law, including any rule of general applicability governing Federal grants for which an opportunity for comment is provided. Certain limited exceptions are allowed (see Section 601(2) of the Act).

The term "small entities" includes small businesses, small organizations, and small governmental jurisdictions. Thus, the coverage of the Act is broader than one might expect; P.L. 96-354 specifically expands the jurisdiction of SBA to bodies other than traditional small businesses.

The Act does allow USDA the option to establish its own standards for defining these three types of entities if an agency opts to do so (either rule-by-rule or on an agency-wide basis). It is likely that some variations will be required in view of the wide diversity of constituencies served by USDA. Agencies of USDA must consult with SBA a week to ten days prior to publication of a proposed rule which does not use a standard definition of small business or entity. Public comment must also be sought.

Keep in mind the fact that a variety of definitions may become confusing, i.e., which entities are small in one case and not small in other cases. On the other hand, a single definition may not satisfy your agency's responsibility under the Act to consider the ability of small entities to comply.

Should your agency decide to issue its own definition or definitions of small business, OMB suggests consideration of the following factors in generating that definition or definitions:

- volume of business
- number of employees
- financial resources
- competitive status or position
- ownership or control of materials, processes, patents, license agreements, facilities and sales territory
- nature of business activity

Sources include census reports, IRS reports, and the SBA Size Standards Division.

If agencies opt not to establish their own definitions of the three types of small entities, the following definitions will apply:

- Small Business - "A small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation." (Sec. 3 of the Small Business Act) SBA has established size standards for certain industries; those standards may be found in 13 CFR 121. (Standards for manufacturing industries focus on the number of employees, while size standards for other major industry categories focus on volume of business. Agricultural enterprises are included. For example, the size standard for agricultural production is $275,000 (average annual gross receipts over three years); for custom livestock feeding, $10,000,000; for farms, $1 million; for manufacturing, 250 employees; for variety stores, $3 million; for food stores, $7.5 million; for grain storage, 1 million bushel capacity; for trucking, $6.5 million; for wholesale operations, $9.5 million. Separate standards obtain for procurement and financial assistance; procurement standards tend to be somewhat higher.) However, please note that SBA size definitions are subject to a number of qualifications and limitations; therefore, the technical provisions of Part 121 must be carefully examined. Furthermore, SBA has proposed to revise its definitions (advance notice of proposed rulemaking published in the Federal Register, March 10, 1980, page 15442); agencies should be alert to any changes which may be issued in 1981.

Small subsidiaries of large firms are not considered "small entities."

As mentioned above, individual agency definitions may be issued.

- Small Organization - "Any not-for-profit enterprise which is independently owned and operated and is not dominant in its field." (Sec 601(4) of P.L. 96-354)

  As mentioned above, individual agency definitions may be issued.

- Small Governmental Jurisdiction - "Governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than 50,000." (Sec 601(5) of P.L. 96-354)

  As mentioned above, individual agency definitions may be issued. The Act specifies that agency definitions must be based on "such factors as location in rural or sparsely populated areas or limited revenues due to the population of such jurisdiction."

No boundaries are specified as to what constitutes a "significant economic impact" nor as to what constitutes a "substantial number of small entities," the basic applicability tests for the Act. This will have to be judged in relative terms on a rule-by-rule basis and of course, those rules must be listed on the agenda, undergo analysis, and be periodically reviewed.

In deciding what constitutes a "significant economic impact, agencies should consider the factors set forth in Section 2 of Secretary's Memorandum 1955. In addition, OMB suggests the following factors:

- Direct and indirect costs of compliance with the rule, calculated both as absolute costs and as a percentage of revenue of the regulated small entity (including, for example, interest rates to small borrowers and ability of small borrowers to borrow at all);

- Direct and indirect costs of completing paperwork or recordkeeping requirements, again both as absolute costs and as a percentage of revenue;

- Effect of the rule on the competitive position of small entities in relation to larger entities;

- Effect of the rule on the small entity's cash flow and liquidity. (For example, does the rule indirectly require the small business to tie up funds?);

- Effect of the rule on the ability of a small entity to remain in the market at all;

- Availability and cost to the small entity of professional assistance to meet regulatory requirements.

In deciding what constitutes a "substantial number of small entities," no single number need apply uniformly. The Congress specifically advocated a rule-by-rule approach. In making this determination, OMB suggests that consideration be given to the following factors:

- Total number of entities in the affected sector compared with the number of small entities;
- Number of geographic areas affected by the rule;
- Number of industries affected by the rule.

Your agency may also want to consider seeking public comment on these definitions. Should there be a need to gather public information for this purpose, your agency may need to request Reports Act clearance from OMB's Office of Regulatory and Information Policy to undertake such an information collection effort.

REGULATORY FLEXIBILITY AGENDA

The requirement for a regulatory flexibility agenda, listing all planned or proposed rules which will have a significant economic impact on a substantial number of small entities, will be combined with the requirement in E.O. 12044 that a regulatory agenda (i.e., the USDA Decision Calendar) be published biannually. Those regulations affecting small entities will simply be identified as such by an informational line in the Calendar entry. Agencies should include all anticipated regulations which are likely to have a significant economic impact on small entities as far in advance as possible.

Currently, the USDA Decision Calendar is published in mid-May and mid-November. However, the Regulatory Flexibility Act requires that this schedule be modified. Henceforth, the Calendar will be published in late April and late October.

The information to be included with respect to small entity entries is virtually the same as that which is already required under the current system (e.g., nature and objectives of the action, legal basis, schedule for completion, and name and telephone number of a contact official). The only additional item which must be listed is the subject area of the item in question. Subject categories will have to be developed (for example, economic, health and safety regulation, etc.).

The law specifies that each agency should "endeavor to provide notice of each regulatory flexibility agenda to small entities or their representatives through direct notification or publication of the agenda in publications likely to be obtained by such small entities and shall invite comments upon each subject area on the agenda." Your agency may obtain mailing lists by Standard Industrial Classification code from SBA.

This office will transmit a copy of the Calendar, with the regulatory flexibility items incorpoated as outlined above, to the Chief Counsel for Advocacy of SBA as required by law.

REGULATORY FLEXIBILITY ANALYSES (INITIAL AND FINAL)

Regulatory flexibility analyses, documenting the impact of the rule in question on small entities, are to accompany both proposed and final rules having significant economic impact on a substantial number of small entities. Initial regulatory flexibility analyses are to accompany proposed rules and final regulatory flexibility analyses are to accompany final rules. (Situations under which analyses may be waived are described below.)

According to E.O. 12044 and the current Decision System, a regulatory analysis accompanying a significant rule must contain the following elements:

- A statement of the problem;
- The legal basis for the rule;
- A description of the major alternatives considered in dealing with the problem;
- An analysis of the economic and other impacts of each alternative;
- A detailed explanation of the reasons for selecting one alternative over the other(s).

(For supplemental information, refer to the 9-25-78 memorandum issued by Howard W. Hjort, Director of Economics, Policy Analysis and Budget, regarding the implementation of Secretary's Memorandum 1955.)

Initial Regulatory Flexibility Analysis

An initial regulatory flexibility analysis will be incorporated into the Draft Impact Analysis. In addition to the requirements established under Executive Order 12044, the following elements must be included under Section 603 of the Act:

"(b) Each initial regulatory flexibility analysis required under this section shall contain—

"(1) a description of the reasons why action by the agency is being considered;

"(2) a succinct statement of the objectives of, and legal basis for, the proposed rule;

"(3) a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply;

"(4) a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record;

"(5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule.

"(c) Each initial regulatory flexibility analysis shall also contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. Consistent with the stated objectives of applicable statutes, the analysis shall discuss significant alternatives such as—

"(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

"(2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities;

"(3) the use of performance rather than design standards; and

"(4) an exemption from coverage of the rule, or any part thereof, for such small entities.

Your agency is now required to publish the initial regulatory flexibility analysis or a summary thereof in the Federal Register at the time of publication of the proposed rule. A copy of that analysis must also be submitted to this office for transmittal to the Chief Counsel for Advocacy of the Small Business Administration.

Final Regulatory Flexibility Analysis

For a final regulatory flexibility analysis, Section 604 of the Act requires the following elements be included:

> "(1) a succinct statement of the need for, and the objectives of, the rule;
>
> "(2) a summary of the issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments; and
>
> "(3) a description of each of the significant alternatives to the rule consistent with the stated objectives of applicable statutes and designed to minimize any significant economic impact of the rule on small entities which was considered by the agency, and a statement of the reasons why each one of such alternatives was rejected.

Only a notice of where the final regulatory flexibility analysis may be obtained need be published, as opposed to the document itself or a summary, which is the case with the initial analysis. This requirement is identical to current procedures on availability of Final Impact Statements.

WAIVER OF ANALYSIS REQUIREMENT

In the event that a rule will not have a significant economic impact on a substantial number of small entities, your agency must provide our office with such a certification stating the reasons. Our office will obtain the needed approval for the certification, which must be published with the proposed and final rule—with regard to both significant and not significant actions. This office will also transmit the certification and statement to the Chief Counsel for Advocacy of the Small Business Administration.

The requirements for an initial regulatory flexibility analysis may be waived or delayed in the case of an emergency rule. A final regulatory flexibility analysis must nevertheless be prepared. No later than the date of final rule publication, a statement must be published in the Federal Register, along with the reasons why the final rule is being promulgated in response to an emergency which made compliance with the requirements for an initial analysis impracticable. The same procedure will be followed as set forth above for certifications of exemption.

Publication of a final regulatory flexibility analysis may be delayed for no more than 6 months (180 days) after publication of the final rule. The law is very specific in stating that a rule will lapse if no final analysis is published within that 6 month period following final notice publication. Before or on the day on which the final rule is published, a statement must be published in the Federal Register, along with the reasons, as to the fact that the final rule is being promulgated in response to an emergency which makes timely compliance with the final analysis requirement impracticable. The same procedure will be followed as set forth above for exemptive certifications.

PUBLIC PARTICIPATION

P.L. 96-354 requires agencies to actively solicit comments from small entities regarding proposed rules which would have a significant economic impact on a substantial number of small entities. This requirement parallels the requirement in E.O. 12044 that agencies afford the public with early opportunities to participate in the development of regulations affecting them.

Agencies are encouraged to transmit copies of the agenda and proposed rules to small entities likely to be impacted. They are also directed to invite comments on each subject area listed in the agenda. In addition, the following outreach efforts are suggested:

- Advance notices of proposed rulemaking with language alerting small entities that the regulation may have a significant economic impact on them;
- Similar language in notices of proposed and final rulemaking;
- Direct contact of interested small entities and/or small entities likely to be affected;
- Open conferences, meetings, or public hearings concerning the rule;
- Publication of notices of proposed rules in journals, newspapers, etc., likely to be read by affected parties;
- Modifications of procedural rules for purposes of reducing the cost or complexity of participation in the rulemaking by small entities.

(For additional information, please see my memo of 8-16-79, entitled "Public Participation Plans.")

PERIODIC REVIEW OF RULES

Both P.L. 96-354 and E.O. 12044 require a periodic review of rules. In selecting rules for review which have a significant impact on a substantial number of small entities, OMB suggests use of the following criteria:

- Continued need;
- Complaints received;
- Burdens imposed;
- Need for clear language;
- Length of time since last review;
- Complexity of the rule;
- Need to eliminate overlapping, duplicative, or conflicting rules (Federal or, if feasible, State);

With regard to the last item, OMB suggests:

- Requesting public comment during the review process;
- Circulating a list of rules scheduled for review to other agencies;
- Using OMB's reports clearance inventory to identify similar paperwork requirements in other agencies.

(The most significant and burdensome regulations are to be reviewed first. For additional information, please see the Mayall/Clemans memo of 3-31-80, entitled "Instructions for Review of Existing Regulations.")

Although E.O. 12044 set no time limits for periodic reviews, USDA imposed a five-year limitation on itself, so the 10-year limit in P.L. 96-354 will be easily met.

However, the Act imposes the added requirement that a plan for the (five-year) review of all existing regulations affecting small entities be published in the Federal Register by June 30, 1981; the purpose of this requirement is to amend those rules which are unduly burdensome to small entities. Thus, your agency must screen its Regulations Review Plan for such regulations, identify them as such and notify the Decision System staff. The review section of the Calendar will continue to be published as formerly, with the addition of the notations accompanying the rules affecting small entities.

The Act also provides for periodic review of rules adopted subsequent to 1-1-81; this requirement parallels USDA's current Sunset Evaluation Plan requirement.

JUDICIAL REVIEW

Despite the fact that no separate review is provided for agency certification that the Act applies or does not apply and intermediate review is barred, some judicial review is possible. P.L. 96-354 specifically states, "When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review." Thus, a court could conceivably condemn a rule as being arbitrary and capricious or otherwise invalid based in part on a substandard regulatory flexibility analysis.

It should also be pointed out that Title II of the Equal Access to Justice Act, signed into law in October of 1980, provides for a 3-year experiment, beginning in October of 1981, during which certain individuals and small businesses may recover legal fees when they prevail in suits. This includes suits brought to invalidate Federal rules, unless otherwise specifically precluded by statute or unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

OVERSIGHT

The Chief Counsel for Advocacy will be closely monitoring compliance with the Act. He is required to report annually on such compliance to the President and four Congressional Committees (Judiciary and Small Business in both the Senate and House of Representatives). The Chief Counsel is also authorized by Section 612(b) and (c) to appear as amicus curiae in any action brought in a court of the United States to review a rule. In any such action, the Chief Counsel is authorized to present his views with respect to the effect of the rule on small entities. A court of the United States shall grant the application of the Chief Counsel for Advocacy of the Small Business Administration to appear in any such action.

The Chief Counsel has offered his assistance in agency implementation of the Act. He may be contacted as follows:

Chief Counsel
Office of Advocacy
1441 L Street, N.W.
Washington, DC 20416
Telephone: 653-6533

Exhibit B

Secretary's Memorandum 1512-1
June 11, 1981

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

June 11, 1981

SECRETARY'S MEMORANDUM 1512-1

Reduction of Regulatory Burdens and Simplification of USDA's Decisionmaking Procedure

1 PURPOSE

This Administration is committed to reducing the burden of Federal regulation on the American economy. As part of this effort, on February 17, 1981, the President issued Executive Order 12291, which sets forth requirements for the promulgation of new regulations and requires the review of existing regulations. USDA will be active and aggressive in carrying out the President's goals. To do this, we must:

a Strengthen the analysis of the real impact of our regulations,

b Simplify our internal decisionmaking procedures,

c Ensure early coordination of regulation development and analytic and legal review activities.

Such measures will not only improve our regulations but also facilitate timely decisions.

This Memorandum establishes USDA responsibilities and procedures which will achieve these objectives and thereby implement Executive Order 12291.

2 COVERAGE

The requirements and responsibilities set forth in this Memorandum are applicable to the promulgation of all new rules and regulations, to the review of existing rules and regulations, and to the development of legislative proposals concerning regulations.

As defined in Executive Order 12291, "RULE" or "REGULATION" means "an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice requirements of an agency."

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Thus, directives and policy reports, as well as regulations developed in informal rulemaking proceedings, may be "rules" under this definition. However, (1) formal (adjudicatory) rulemaking, (2) regulations issued with respect to military or foreign affairs functions of the United States, and (3) any regulations related to agency organization, management, or personnel are specifically excluded.

3 GENERAL REQUIREMENTS APPLICABLE TO MAJOR AND NONMAJOR REGULATIONS

Within their respective jurisdictions, Under Secretaries and Assistant Secretaries are responsible for determining which rules and regulations shall be designated as "major."

MAJOR REGULATIONS under the Executive Order and this Memorandum are those likely to result in one or more of the following:

a An annual effect on the economy of $100 million or more; or

b A major increase in costs or prices for consumers; individual industries, Federal, State or local government agencies, or geographic regions; or

c Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

Staff of the Office of the General Counsel and the Office of Budget, Planning and Evaluation shall be available to assist in making this initial determination. Each Under Secretary and Assistant Secretary shall establish a procedure by which he or she is advised at an early stage in the development of proposed regulations and provided with sufficient information and preliminary analysis to determine the potential impact of the regulation.

The development of, and decisions on, regulations will be made consistent with the requirements of Executive Order 12291.

Comment Period

Agencies shall provide for a 60-day comment period on proposed rules. If a regulation is being promulgated because of an emergency, so that a 60-day comment period is not feasible, or if the nature of the regulation warrants a shorter period, a shorter period may be used. If the emergency requires publication without any comment period, comments should be solicited following publication, unless good reasons exist for proceeding without such comment. OGC concurrence is required for any decision which provides for less than 60 days comment.

Any regulation promulgated after public notice and an opportunity for public comment which has a significant economic impact on a substantial number of small entities is subject to the analytic requirements of the Regulatory Flexibility Act (Public Law 96-354) and any regulation with information collection (reporting or recordkeeping) requirements is subject to the requirements of the Paperwork Reduction Act (Public Law 96-511). Agencies shall take appropriate steps to coordinate compliance with these requirements with Executive Order 12291 compliance.

Under the Executive Order, all regulations other than those exempted by the Executive Order must be submitted to OMB for review. Expedited procedures are available for regulations issued in emergency situations or in response to statutory or judicial deadlines. Efforts should be made to incorporate OMB review into the schedule for the development of regulations in response to statutory or judicial mandates.

Exemptions from OMB review may be requested for particular regulations or classes of regulations. Requests to waive the requirements or procedures of Executive Order 12291 (to be submitted to OMB) for individual regulations or for classes of regulations and requests to waive the requirements of this Memorandum shall be decided by the program Under Secretary or Assistant Secretary.

4 REQUIREMENTS FOR MAJOR REGULATIONS

Every major regulation must be supported by a regulatory impact analysis as described in Executive Order 12291 and such guidelines as may be issued. Both the regulation and the analysis must be submitted to OMB at the proposal and final stages. The appropriate Under Secretary or Assistant Secretary shall designate who is responsible for completing the analysis. It is expected that in most cases this will be the line agency with jurisdiction over the program(s) involved in the regulation.

Staff of the Office of the General Counsel and the Office of Budget, Planning and Evaluation shall be available to assist Under Secretaries and Assistant Secretaries in completing the regulation and impact analysis. This will help to assure proper coordination and smooth functioning of the clearance process.

The clearance process for major regulations and impact analyses shall include the agency head, the Assistant Secretary for Economics, the Office of Budget, Planning and Evaluation, the General Counsel and the program Under Secretary or Assistant Secretary. The Secretary and the Deputy Secretary shall be provided with a summary of the regulation and analysis when the agency head clears the docket and, at their options, may select to review and clear particular regulations.

5 REQUIREMENTS FOR NONMAJOR REGULATIONS

Although the Executive Order does not establish specific analytic requirements for nonmajor regulations, such regulations shall be reviewed to ensure that they are cost-effective and consistent with an agency's authority. Agencies will establish internal procedures to conduct such reviews for cost-effectiveness. The Office of the General Counsel will review to ensure that regulations are within the agency's authority and are otherwise legally sufficient. In addition, all such regulations which are not exempted by the Executive Order must be submitted to OMB for review prior to publication at the proposal and final stages.

Under Secretaries or Assistant Secretaries may identify nonmajor regulations for special oversight and economic analysis. They shall make such arrangements as they wish to ensure that such oversight occurs. Analyses shall be the responsibility of the agency.

Designated nonmajor regulations and analyses of such regulations shall be reviewed and approved by the appropriate Under Secretary or Assistant Secretary at the proposal and final stages. All other nonmajor rules shall be reviewed and approved by the agency head.

6 EXISTING RULES AND REGULATIONS

Each agency shall immediately conduct a preliminary screening of its existing regulations. This screening shall be designed to:

(1) determine which of its existing regulations are "major"; and

(2) establish a priority list and timetable for the review of all existing regulations.

The preliminary review shall be completed by the agency by July 1, 1981, and the proposed priority list and timetable shall be submitted to the appropriate Under Secretary or Assistant Secretary for approval. In establishing the priority list, the agency shall consider the potential for reducing unnecessary regulatory burdens, the impact (particularly the costs) of the regulation, and when the regulation was last subjected to an extensive review. The timetables estabished shall also assure that no regulation exists for more than five years without being reviewed.

Except where the OMB Director or the Secretary require an earlier review, the timetables shall be adhered to unless good cause is shown.

Review of major and nonmajor regulationsshall follow the procedures set forth in this Memorandum with Regulatory Impact Analyses completed on major regulations.

7 SEMIANNUAL REGULATORY AGENDA

The Office of Budget, Planning and Evaluation will maintain and publish, pursuant to the requirements of Executive Order 12291 and the Regulatory Flexibility Act, the semiannual Regulatory Agenda.

8 GUIDELINES

The General Counsel, in consultation with the Office of Budget, Planning and Evaluation, shall issue guidelines for the implementation of this Memorandum, Executive Order 12291 and the Regulatory Flexibility Act.

9 REVOCATION OF PRIOR MEMORANDUM

Secretary's Memorandum No. 1955 is hereby revoked.

John R Block

John R. Block
[illegible]

GUIDELINES FOR IMPLEMENTATION

OF SECRETARY'S MEMORANDUM NO. 1512-1

for

Reduction of Regulatory Burdens
and Simplification of USDA's
Decisionmaking Procedure

I. PURPOSE

These guidelines specify the responsibilities and procedures for the Department's implementation of Executive Order 12291, Secretary's Memorandum No. 1512-1, and the Regulatory Flexibility Act.

II. COVERAGE

Executive Order 12291 and Secretary's Memorandum No. 1512-1 establish requirements regarding the promulgation of all new regulations, the review of existing regulations, and the development of legislative proposals concerning regulations.

As defined in Executive Order 12291, "rule" or "regulation" means "an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice requirements of an agency." Thus, directives and policy reports, as well as regulations developed in informal rulemaking proceedings, may be "rules" or "regulations" under this definition. However, (1) formal (adjudicatory) rulemaking, (2) regulations issued with respect to military or foreign affairs functions of the United States, and (3) any regulations related to agency organization, management, or personnel are specifically excluded.

The Regulatory Flexibility Act covers all regulations promulgated after public notice and an opportunity for public comment.

III. OVERSIGHT BY AND EARLY INFORMATION TO UNDER SECRETARIES AND ASSISTANT SECRETARIES

In order to maintain policy oversight regarding the development of regulations, each Under Secretary and Assistant Secretary should review the objectives of and need for contemplated regulations, estimates of costs of the contemplated regulation and likely alternatives, and a preliminary timetable for the development of the regulation to enable him/her to identify "major" actions and direct the development of regulatory policy. A "work plan" (Attachment 1) is suggested to provide such information. This plan includes brief descriptions of the objectives of and the need for contemplated actions, estimates of costs of likely alternatives, and a preliminary timetable for the development of the regulation.

If an Under Secretary or Assistant Secretary determines that the early information is not necessary for certain categories of "nonmajor" actions, he/she should designate those categories for which work plans will not be required. If the work plan is not used, OBPE should be informed of what method will be used or if early information is not required for particular types of nonmajor actions.

Agencies and independent offices have responsibility for bringing contemplated regulations to the early attention of the appropriate program Under Secretary or Assistant Secretary using work plans or other approved procedures. Such information should be provided sufficiently early in the process of developing the regulation to permit the Under Secretary or Assistant Secretary to direct the development of the regulation or to terminate the project before substantial resources have been expended. Under Secretaries and Assistant Secretaries should provide specific instructions to their agencies as to the time at which such information should be submitted to enable them to provide such direction.

The work plan, prepared by the agency, should be reviewed by the Under or Assistant Secretary to:

- o Designate "major" actions, i.e. those which are likely to result in one or more of the following:
  - --An annual effect on the economy of $100 million or more; or
  - --A major increase in costs or prices for consumers; individual industries; Federal, State or local government agencies; or geographic regions; or
  - --Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.
- o Designate nonmajor actions over which the Under Secretary or Assistant Secretary wants to maintain oversight or have special analyses conducted, referred to as "designated nonmajor" actions. Such designation is appropriate for actions that would:
  - --Establish new policies or substantially modify existing policies or programs; or
  - --Affect budget outlays substantially; or
  - --Affect more than one agency; or
  - --Be likely to be controversial.
- o Designate "nonmajor" actions which will thereafter be developed under agency oversight.

While many individual regulations will not be considered "major," Under Secretaries and Assistant Secretaries should consider whether related regulations should be jointly designated as "major" or "designated nonmajor." Staff of OBPE and OGC are available to assist Under Secretaries and Assistant Secretaries in making the determination of whether regulations are "major" or should be designated for special analysis or oversight. After the Under Secretary or Assistant Secretary designates an action as provided in this section, a copy of the work plan, or other document which indicates the nature of the action and the designation should be sent to OBPE.

IV. DEVELOPING RULES

The Executive Order sets out general requirements that rules be based on adequate information regarding the need for and consequences of government action; cost-effective and provide maximum benefit; and within the promulgating agency's authority. In addition, the Executive Order requires that all regulations be submitted to OMB for review. In order to ensure that these objectives are attained, this section of the guidelines sets forth procedures regarding all regulations as well as particular procedures for regulations designated as "major."

A. General Requirements Applicable to Major and Nonmajor Regulations

In order to implement E.O. 12291, as well as improve Department rulemaking and compliance with the requirements of the Administrative Procedure Act, agencies should:

o Ensure that notices of proposed and final regulations to be published in the Federal Register contain all of the information specified in Attachment 2. (Attachment 2 should be used as a "check list" on the preparation of rulemaking documents.) The following items to be included in the "Supplemental Information" are new requirements or modifications of past practices:

--The document should contain a statement as to whether a regulation is major or nonmajor and give reasons for that determination. If possible, the reason should be stated in positive terms, e.g. what the estimated annual effect on the economy is or what the impact in cost or prices or other effects of the rule would be.

--The comment period on proposed regulations generally should be 60 days. If an emergency or other good reason exists, such as the need to meet a statutory deadline, a period of less than 60 days may be used. This is intended to give agencies sufficient flexibility where action is necessary in a shorter period. Regulations issued on an emergency basis should generally be issued as interim final rules and comments solicited following publication of the regulation. Emergency regulations may be issued as final rules without a comment period if there is good reason not to solicit comment on the rule. OGC concurrence is required for any proposal which provides for less than 60 day comment period.

--For emergency regulations, the document should explain the basis for that determination and, if the emergency is such that compliance with E.O. 12291 is not practicable, the reasons why it is not practicable.

--A summary of the cost-effectiveness of the regulation must be included. If the regulation is major, the document should summarize the Regulatory Impact Analysis. If it is nonmajor, the document should delineate the basis for the regulatory approach taken as will reveal the agency's compliance with the Executive Order's requirement that agencies choose the alternative that maximizes net benefit to society at the lowest net cost.

--The document should indicate the status of OMB clearance for any reporting or recordkeeping requirements, in accordance with the Paperwork Reduction Act of 1980 (P.L. 96-511). If OMB clearance has been granted, the OMB clearance number should be stated. Unless OMB clearance has been obtained, agencies may not establish recordkeeping or reporting requirements. The basis for OMB clearance for such requirements is a determination by the Director of OMB that the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility for the agency.

- Ensure that analytic requirements regarding regulations established by law and the Executive Order are met. (This includes Regulatory Impact Analysis, Regulatory Flexibility Analysis, Urban and Community Impact Analysis, Environmental Assessments, and Environmental Impact Statements.) To the extent possible, all analytic requirements applicable to any regulation shall be covered in one consolidated document for that action.

--To comply with the Regulatory Flexibility Act's analytic requirements, agencies should establish criteria to determine whether a "rule" (as defined in P.L. 96-354) will have "a significant economic impact on a substantial number of small entities". Using those criteria, if the agency heads determine that a "rule" will not have such an impact, a certification of that determination by the agency head must be submitted to the Chief Counsel, Office of Advocacy, U.S. Small Business Administration. If the agency head cannot so certify, a Regulatory Flexibility Analysis must be completed and the regulation listed in the Department's Semi-Annual Regulatory Agenda.

- Ensure that the factual conclusions upon which the regulation is based have substantial support in the agency record.

- Ensure that the SF 83 and such other cover sheets as may be required for transmittal to OMB are completed, including information regarding all recordkeeping and reporting requirements. Four copies of the cover sheet and regulation must be transmitted to OMB for review of regulations containing recordkeeping or reporting requirements; three copies must be transmitted if no recordkeeping or reporting requirements are included.

- Transmit a copy of each proposed or final regulation to OBPE when it is transmitted to OMB so that OBPE can maintain Department-wide records of the status of proposed and final regulations.

- Determine if additional action should be taken to solicit comments on proposed regulations, considering who is affected and which additional means should be used to obtain comment from the affected public, e.g. direct mailings, public notices, etc.

- Maintain a file for each proposed regulation containing copies of all Federal Register notices regarding the regulation, background data on which the proposed regulation is based, analyses conducted by the agency, comments received from the public, transcripts of any meetings or hearings, and any other data which will be considered in the decision to promulgate the final regulation. The maintenance of such a record will not only facilitate the decisionmaking process, but will also facilitate preparation for the defense to any legal challenges to promulgated regulation.

- Update and correct agency entries in the USDA Regulatory Agenda on a continuing basis. This must be done on all items on the Agenda including major regulations, regulations requiring Regulatory Flexibility Analysis, and any other entries that may be required.

B. Special Requirements for Major Rules

Executive Order 12291 establishes special analytic requirements and review procedures for regulations designated as "major" (see criteria p. 2). Specifically:

- A preliminary and final Regulatory Impact Analysis (RIA), must be prepared at the proposed and final stages of rulemaking, respectively. The Executive Order requires that analyses include a discussion of the need for regulatory action; the alternatives for addressing the problem; an estimate of the costs and benefits of the alternatives; and an explanation of why the selected alternative was selected. If the selected alternative is not the lowest cost option, the RIA should explain the legal reasons why such alternative(s) could not be adopted.

- A memorandum of law prepared by OGC regarding the agency's authority to issue the regulation must be included in the Federal Register notice of promulgation of the regulation.

- All major regulation and analyses must be submitted to OMB 60 days before the publication of a proposed regulation, and 30 days before publication of a final regulation, unless the regulation is an emergency or a waiver of the procedures of Executive Order 12291 has been granted by OMB.

The program Under or Assistant Secretary is responsible for designating who is responsible for completing analyses. In most instances, it will be the agency responsible for the program involved in the rule. In order to carry out their analytic responsibilities, agencies are encouraged to establish analytic staffs. In addition, an OBPE analyst will be designated for each major rule and will be available to work with the agency analytic staff in the preparation of analyses.

To ensure that rules will be developed within an agency's authority and to facilitate timely completion of the required memorandum of law, OGC will assign an attorney to be available to work with the agency in the preparation of each major rule.

Major regulations and RIAs should be presented as a package and be cleared in the following order:

--Agency Head.

--Office of Budget, Planning and Evaluation.

--Assistant Secretary for Economics.

--General Counsel.

--Under/Assistant Secretary.

In order to facilitate the clearance process, after the agency head approves the regulation and analysis, the agency should forward the clearance copy of the package to the Assistant Secretary for Economics, and advance information copies to OBPE, the General Counsel and the Under Secretary or Assistant Secretary so that they may begin their review before they receive the formal clearance copy.

In addition, a memorandum summarizing the rule and its impact should be prepared for the Secretary and Deputy Secretary and forwarded to them by the Under Secretary or Assistant Secretary when the agency head has cleared the package. The Secretary and Deputy Secretary can then select those rules which they wish to clear. If they have not informed the Under Secretary or Assistant Secretary of their intentions to clear a regulation by the time the Under Secretary or Assistant Secretary has cleared it, the regulation may be transmitted to OMB without further clearance.

C. Requirements for Nonmajor Rules

The Executive Order does not establish specific analytic requirements for nonmajor regulations to ensure that regulations maximize benefit at the lowest net cost. To achieve this goal, agencies should review each proposed and final regulation and the alternative means of achieving the regulatory goals to determine the relative cost-effectiveness of the selected regulatory approach.

For designated nonmajor regulations, the Under Secretary or Assistant Secretary may develop whatever procedures he/she feels necessary for oversight and analysis. It is recommended that specific procedures be established and communicated to regulation development and analytic staffs to ensure that desired oversight and analysis occurs. Under Secretaries and Assistant Secretaries should instruct staffs at the time of designation of particular analytic requirements or information they wish to review regarding particular designated nonmajor regulations. OBPE staff will be available to assist agency program staff in the development of analyses.

Designated nonmajor regulations must be cleared by the agency head, the General Counsel and the Under or Assistant Secretary. Analyses of such regulations must be cleared by the agency head and Under Secretary or Assistant Secretary.

All nonmajor regulations must be submitted to OMB 10 days before publication at the proposal and final stages.

D. Review of Existing Regulations

The Executive Order requires the review of all existing currently effective regulations and the Secretary's Memorandum requires that, by July 1, 1981, each agency conduct a preliminary screening of its existing regulations designed:

(1) to determine which of its existing regulations are "major" or have a significant economic impact on a substantial number of small entities or should be subject to special analysis; and

(2) to establish a priority list and timetable for the review of all existing regulations.

The proposed priority list and timetable must be submitted to the appropriate Under Secretary or Assistant Secretary for his/her approval. After the Under Secretary or Assistant Secretary approves the list and timetable, copies should be sent to OBPE.

In establishing the priority list, each agency must consider the potential for reducing unnecessary regulatory burdens, the impact (particularly the costs) of the regulation, and when the regulation was last subjected to an extensive review. The timetables established should also ensure that no regulation exists for more than five years without being reviewed. If the agency has previously established timetables for the review of existing regulations, including schedules for annual reviews of program regulations, new timetables need not be established. However, such schedules should be examined to designate "major" regulations and those with a significant economic impact on a substantial number of small entities and ensure that analyses required by the Executive Order and Regulatory Flexibility Act can be carried out within the previously established time frames. Except where the OMB Director or the Secretary require an earlier review, the agency timetables shall be adhered to unless good cause is shown.

In conducting the review, agencies should consider whether an existing regulation is still needed and, if needed, whether simplification or modifications should be proposed to reduce costs to the regulated entities or the Department. Particular attention should be paid to information collection (reporting and recordkeeping) requirements to determine (1) if OMB has cleared the requirement within the last three years and (2) if proposals can be made to reduce the burdens imposed by such requirements.

If modifications or rescission of regulations appears appropriate, rulemaking should be initiated as early as possible. If an information collection requirement has not been approved by OMB within the last three years, appropriate documentation for OMB clearance should be prepared.

RIAs must be prepared for existing major regulations and Under Secretary and Assistant Secretaries may designate nonmajor regulations for special analysis. Agencies should consider whether several regulations within a program should be aggregated for purposes of such analysis.

Staffs of OGC and OBPE will be available to assist in the review and analysis of existing regulations.

V. OTHER DEPARTMENTAL RESPONSIBILITIES

A. Office of the General Counsel Responsibilities

The General Counsel will ensure compliance with the Executive Order by reviewing documents prepared for publication in the Federal Register for legal sufficiency. In addition, the Office of the General Counsel will do the following:

--When a contemplated action is designated "major," OGC will assign an attorney to work with agency rule development staff in drafting the regulation and to complete the required memorandum of law showing that the regulation is clearly within the agency's authority.

--If an agency rejects alternatives for a major rule which could substantially achieve the regulatory goals at lower cost, OGC will prepare an explanation for use in the analysis of the legal reasons why such alternatives could not be adopted.

--Concur in decisions to solicit comments on proposed regulation for less than 60 days because of emergencies or other special circumstances.

B. Office of Budget, Planning and Evaluation Responsibilities

The Director of OBPE will provide staff assistance to Under Secretaries and Assistant Secretaries in regulatory policy oversight and in the preparation of Regulatory Impact Analyses, as follows:

--Assist program Under or Assistant Secretaries, at their request, in determining which rules are major or should be designated for oversight or analysis; advise them regarding issues that the

Under Secretary or Assistant Secretary may wish to direct the agency to consider in connection with contemplated regulations and prepare instructive memoranda to agencies, as needed, for Under Secretary or Assistant Secretary signature.

--Assist agency analysts in the development and clearance of their analyses. An OBPE analyst shall be assigned to assist in the analysis of major rules and shall be available at the request of the Under Secretary or Assistant Secretary for designated nonmajor rules.

--Oversee implementation of the Regulatory Flexibility Act.

--Prepare the Regulatory Agenda for publication in April and October of each year as required by the Regulatory Flexibility Act and Executive Order 12291. OBPE shall establish procedure to ensure that material is acquired from each agency so that all entries are updated in a timely fashion.

--Maintain records regarding the status of proposed and final regulations to OMB.

VIII. EFFECTIVE DATE

The effective date of the Executive Order on which Secretary's Memorandum No. 1512-1 and these guidelines are based was February 17, 1981. These guidelines are effective immediately upon issuance. However, regulations published as proposals under previous requirements need not be reproposed. Such regulations need only comply with the new requirements at the final stage.

AD 763 (4-81)

U.S. DEPARTMENT OF AGRICULTURE

WORK PLAN

SIGNATION OF OVERSIGHT: (completed by Under or Assistant Secretary and returned to OBPA)

☐ Non-major, agency oversight ☐ Non-major, Under/Assistant Secretary Oversight ☐ Major, Under/Assistant Secretary Oversight Signature Date	Instructions to Agency and/or OBPA

DESCRIPTION OF CONTEMPLATED ACTION (completed by the Agency and sent to OBPA)

Descriptive Title:

Describe Objectives of, and Need for Government Action:

☐ Check indicating Regulatory Flexibility Analysis appears to be required.

ALTERNATIVES AND EXPECTED EFFECTS: Briefly outline the alternatives and summarize the expected effects of this action to the extent they are known at this time and attach on one single-spaced sheet.

PROJECTED SCHEDULE (enter dates; if none planned, enter "none")

PRE-NOTICE:	PROPOSAL:	HEARINGS/MEETINGS:	FINAL:

AGENCY CONTACT (Name, mailing address, phone):

ET AND REGULATORY AGENDA NUMBER ☐☐ ☐☐ ☐☐☐☐☐ year month serial	AGENCY/OFFICE:	APPROVED FOR AGENCY (For Agency Head)	DATE APPROVED

Attachment 2

Outline for Preamble and Text for Notice of Proposed and Final Rules

This outline is provided to serve as a checklist to be used in the preparation of Federal Register documents regarding proposed or final regulations. Items are listed in the order preferred, but not required. Not all items are necessary or appropriate for all types of regulations. Also, the extent of text used for each item should be tailored to reflect the importance and complexity of the action being taken.

Header Used by FR	Elements of the Entry
--	Billing Code
--	Department name
--	CFR parts affected
--	Descriptive title
AGENCY:	Agency or office of the Department
ACTION:	Indicate the type of action. For instance, Notice of Proposed Rulemaking; Final Rule; Prenotice; Advanced Notice of Proposed Rulemaking; Notice of Meeting; etc.
SUMMARY:	Summarize the action (required by 1 CFR 18.12) by briefly describing: o The action being taken. o The circumstances creating the need for the action. o The objectives and effects of the action.
DATES:	State all relevant dates including any of the following: o Comments must be received on or before __________ (Period should be at least 60 days unless an emergency or other reason warrants a shorter period.) o Date and times of hearings or meetings and their locations. Coordinate this with the information in "Addresses," below. o Effective date (estimated for proposals; actual for finals.)

ADDRESSES:	Identify all necessary addresses. If none, omit this entry. o Name(s) and addresses(s) to which comments should be sent. o Addresses of hearings and of individuals to contact for advance material, to place items on the agenda, to reserve space, etc.
FOR FURTHER INFORMATION CONTACT:	Identify the name, title, mailing address and telephone number of a knowledgeable agency official whom the public can contact for further information. Indicate the availability of any analytic statements relating to the action.
SUPPLEMENTARY INFORMATION:	Assure that (1) legal statements required for this action are made and (2) readers who are not expert in the subject area will understand the action. o State whether the rule is major or nonmajor; give the reasons for determination. o If the rule is major, briefly summarize the preliminary or final Regulatory Impact Analysis. o Certify the inapplicability of the Regulatory Flexibility Analysis requirement or indicate that it applies and whether an analysis has been conducted. o Indicate what other analytic requirements are applicable, if any. For instance, Urban and Community Impact Analysis, Environmental Impact Statement, etc. o If the action is being issued with less than 60 days comment period or as an emergency without prior comment or without any comment period, explain the reasons. o If the action is an emergency, explain the basis for that determination and, if the emergency is such that compliance with E.O. 12291 is not practicable, the reasons why it is not practicable. o Explain the need for governmental action and the Department's objectives or alternative objectives with respect to the problems.

- Summarize the major alternative actions considered, their technical and financial feasibility, and their expected direct and indirect economic, health and social effects. Identify the favored or final alternative and reasons.

- Discuss the highlights of the action, clarify complexities and draw the public's attention to new provisions, as appropriate.

- Indicate the status of OMB clearance for any affected reporting or recordkeeping requirement. If OMB clearance has been granted, the OMB number should be stated.

- If the regulation pertains to Federal assistance programs, state the applicability of OMB Circular A-95 review requirements.

- For final major regulations, include the memorandum of law prepared by OGC as required by E.O. 12291, Section 4(a). Precede the memorandum with a center header such as "Memorandum of Law."

- For final regulations, summarize comments received, if any, and USDA's response.

#

Words of issuance (required if the signature appears before the text)

Text of Regulation or Action

- Amendatory language

- Table of Contents (if necessary)

- Authority citation

- Text

Signature--Note that major proposed and final actions must be signed by an Under Secretary or Assistant Secretary or above.

For all Federal or federally-assisted program announcements, indicate the official program number and title listed in the Catalog of Federal Domestic Assistance Programs, as outlined in OMB Circular A-89.

Exhibit C

Current Implementing Directive

December 15, 1983

U.S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C. 20250

DEPARTMENTAL REGULATION	NUMBER: 1512-1
SUBJECT: USDA Regulatory Decisionmaking Requirements	DATE: December 15, 1983
	OPI: Office of Budget and Program Analysis

1 PURPOSE

The purpose of this directive is to enhance the goal of regulatory reform, to impose the least burden of regulation on the public and to assure implementation of cost-effective regulations which are consistent with statutory requirements and policy objectives.

To that end, this directive identifies requirements of Executive Order 12291, hereafter "the Executive Order" and otherwise applicable requirements of the Administrative Procedure Act, the Regulatory Flexibility Act, and the Paperwork Reduction Act. The directive allocates responsibilities among USDA officials and agencies, and defines internal procedures to accomplish the following goals:

a Oversight of contemplated regulations at an early stage to assure consistency with Administration policy and appropriate allocation of agency resources;

b Analysis of contemplated regulatory actions to assure that the most cost-effective means of accomplishing an objective is chosen; and

c Review proposed and final regulations and legislative proposals to assure consistency with the substantive and procedural requirements of law and the Executive Order.

This directive is intended only to improve the internal management of the Department and is not intended to create any right or benefit, substantive or procedural, enforceable at law by a party against the Department, its agencies, its officers or employees or any other person.

2 DEFINITIONS

a "Rule" or "Regulation" refers to an agency statement of general applicability and future effect designed to implement, interpret or prescribe law or policy or describing the procedure or practice requirements of an agency. However, (1) formal (adjudicatory) rulemaking, (2) regulations issued with respect to military or foreign affairs functions of the United States, and (3) any regulations related to agency organization, management or personnel are specifically excluded.

DISTRIBUTION: 15

b "Major" regulations are those which are likely to result in one or more of the following:

(1) An annual effect on the economy of $100 million or more; or

(2) A major increase in costs or prices for consumers; individual industries; Federal, State or local government agencies; or geographic regions; or

(3) Significant adverse effects on competition, employment, investment, productivity, innovation or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

c "Reserved Nonmajor" regulations are nonmajor regulations over which the appropriate Under Secretary or Assistant Secretary wants to reserve oversight or have special analyses conducted. Such designation is appropriate for actions that are nonmajor but that might:

(1) Establish new policies or substantially modify existing policies or programs; or

(2) Affect budget outlays substantially; or

(3) Affect more than one agency; or

(4) Be likely to be controversial.

d "Nonmajor" regulations are those that fall into neither the "major" nor the "reserved nonmajor" categories. Actions designated nonmajor by the appropriate Under Secretary or Assistant Secretary will thereafter be developed under agency oversight.

While many individual regulations will not be considered "major," the appropriate Under Secretary and Assistant Secretary should consider whether related regulations, taken together in a group, should be jointly designated as "major" or "reserved nonmajor."

3 RESPONSIBILITIES

a Agency Heads will:

(1) Provide early information to the appropriate Under Secretary or Assistant Secretary on contemplated regulatory actions

using the Work Plan (Form AD-763, see figure 1 for a sample copy), or other procedures established by the Under Secretary or Assistant Secretary;

(2) Ensure that each action meets the requirements of this directive, the Administrative Procedure Act, any other relevant statutes, and the Executive Order;

(3) Prepare regulations within their scope of responsibility, perform required analysis of these regulations (see section 4), complete SF-83's for all regulations requiring OMB approval (see section 6) and submit all regulations requiring OMB approval to OMB with a courtesy copy to OBPA and OIRM;

(4) Approve dockets for all regulations and, when applicable, forward dockets to policy officials for policy level review and signature;

(5) Maintain up-to-date Regulatory Review Plans for review of existing regulations, assure that reviews are conducted on a timely basis, and maintain adequate records of conclusions of such reviews;

(6) Maintain a regulatory file of documents pertaining to each regulatory action containing records from the proposal stage through final publication; and

(7) Update and correct agency entries in the USDA Semi-Annual Regulatory Agenda on a continuing basis. This must be done on all items on the Agenda including major regulations, entries requiring Regulatory Flexibility Analyses, and any other entries that may be required.

b Under Secretaries and Assistant Secretaries will:

(1) Review agency statements of the need for, objectives, estimated costs of and proposed timetable for contemplated regulatory actions early in their development, and:

(a) Designate the oversight required:

1 Major;
2 Reserved Nonmajor; or
3 Nonmajor

(b) Direct the development or termination of the regulation, as needed.

After the appropriate Under Secretary or Assistant Secretary designates an action as provided in this section, a copy of the Work Plan or other document which provides the necessary information on the action and the designation must be sent to OBPA for inclusion in the USDA Semi-Annual Regulatory Agenda.

(2) Approve Regulatory Impact Analyses and dockets for major regulations, and those nonmajor regulations over which they requested direct oversight and/or the completion of such an analysis; and

(3) Approve priorities, timetables and adjustments thereto for agency review of existing regulations under their Regulatory Review Plans.

c The Assistant Secretary for Economics will review Regulatory Impact Analyses on major regulations to ensure that the analytic techniques used are adequate, that the analysis is accurate, that analytic requirements have been met and that reasonable alternatives have been considered.

d The General Counsel will:

(1) Review regulations for legal sufficiency. This includes the reasons offered why the action is taken without a public comment period, or why an emergency exists which requires implementation with no prior comment period, as appropriate.

(2) Prepare a memorandum of law, as required by the Executive Order, showing that any major regulation is clearly within the authority delegated by law to the Department or one of its constituent agencies.

(3) Assist agency staff, as needed, in drafting regulations and in the event the lowest cost alternative is not chosen for a major regulation, review the adequacy of the explanation of the legal reasons why such alternatives were not adopted.

e The Director of the Office of Budget and Program Analysis will:

(1) Review and clear major regulatory actions and Regulatory Impact Analyses to assure consistency with program policy and budgetary objectives, adequacy of analyses and programmatic soundness;

(2) Advise Under Secretaries or Assistant Secretaries on contemplated regulatory actions through reviewing Work Plans or other materials, as requested;

(3) Assist agency analysts in the development and clearance of Regulatory Impact Analyses, as requested;

(4) Coordinate the clearance of regulations through OMB including responding to inquiries from OMB, maintaining records of transmittals and clearances and notifying agencies of OMB action; and

(5) Produce the USDA Semi-Annual Regulatory Agenda as required by the Regulatory Flexibility Act and the Executive Order.

f The Assistant Secretary for Administration will:

(1) Review through the Office of Information Resource Management all major regulatory actions to evaluate information collection or recordkeeping requirements;

(2) Review through the Office of Equal Opportunity all civil rights impact statements of actions having a significant civil rights impact; and

(3) Assist agencies in the identification and costing of information collection and recordkeeping agreements and in developing civil rights impact statements, as requested.

4 DOCUMENTATION AND ANALYSIS REQUIREMENTS FOR REGULATIONS

Agencies have responsibility for preparation of regulations and analyses in compliance with law and this directive, and for maintaining necessary records of decisionmaking. This section lists requirements in order of the stages of development of a regulation. All the items listed may not be applicable for certain individual actions or classes of actions. The requirements are as follows:

a Early Information to Policy Officials on Contemplated Regulatory Actions. This is submitted by the agency either by Work Plan, see copy in figure 1, or by other means as determined by the appropriate Under Secretary or Assistant Secretary. The policy official's designation of major, reserved nonmajor or nonmajor must be recorded on the Work Plan or other document.

b Compliance with the Paperwork Reduction Act and 5 CFR 1320 in the Development of Regulations. Agencies preparing regulatory actions introducing new or substantially changing existing OMB-approved information collection requirements or recordkeeping requirements must ensure that each such requirement has practical utility and that all reasonable alternatives for acquiring needed information have been considered. (Agency program, regulatory liaison and reports management personnel can aid agency management in fulfilling this responsibility.) In addition:

(1) As provided in section 6, agencies must prepare an SF-83 to transmit the regulations for OMB clearance. A separate SF-83 and justification statement must be submitted for each new or substantially changed information collection requirement or recordkeeping requirement that is included in the regulations.

The separate OMB paperwork clearances can be temporarily avoided if the agency makes only general references to its authority to create information collection requests or recordkeeping requirements rather than specifying the details of such requirements. This permits the provisions of the regulation to take effect. Any specific information collection request or recordkeeping requirement developed to implement these general authorities in the regulation must clear OMB and get an OMB control number before it can be put into effect.

(2) Agencies must also include the OMB control number for any information collection or recordkeeping requirements mentioned in issuance published in the Federal Register. The number must be displayed in such a manner that it will be included in the regulatory text in the Code of Federal Regulations for regulations that appear there.

c Analytic Requirements. A single, unified analytic statement should be completed where possible to meet all applicable analytic requirements. The analytic requirements which may be applicable to regulations and the conditions under which they are applicable are as follows (this list includes the key requirements, but is not exhaustive):

(1) Decision Criteria and Cost-Benefit Analysis Requirements for All Regulations. Section 2 of the Executive Order states that all regulations and legislative proposals, to the extent permitted by law, shall adhere to the following requirements:

(a) Administrative decisions shall be based on adequate information concerning the need for and consequences of proposed government action;

(b) Regulatory action shall not be undertaken unless the potential benefits to society from the regulation outweigh the potential costs to society;

(c) Regulatory objectives shall be chosen to maximize the net benefits to society;

(d) Among alternative approaches to any given regulatory objective, the alternative involving the least net cost to society shall be chosen; and

(e) Agencies shall set regulatory priorities with the aim of maximizing the aggregate net benefits to society, taking into account the condition of the particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future.

(2) Regulatory Impact Analysis for Major Regulations. The Executive Order requires that a Regulatory Impact Analysis be performed on all "major" regulations. Each preliminary and final Regulatory Impact Analysis for major regulations shall contain sufficient information to meet the requirements in section 4c(1), above, as well as the following information required by section 3(d) of the Executive Order:

(a) A description of the potential benefits of the rule, including any beneficial effects that cannot be quantified in monetary terms, and the identification of those likely to receive the benefits;

(b) A description of the potential costs of the rule, including any adverse effects that cannot be quantified in monetary terms, and the identification of those likely to bear the costs;

(c) A determination of the potential net benefits of the rule, including an evaluation of effects that cannot be quantified in monetary terms;

(d) A description of alternative approaches that could substantially achieve the same regulatory goal at lower cost, together with an analysis of this potential benefit and costs and a brief explanation of the legal reasons why such alternatives, if proposed, could not be adopted.

(3) Regulatory Flexibility Analysis or Certification.

(a) The requirements of section 4c(3)(b) and (c) apply to a proposed or final rule if the head of the agency cannot certify that the rule will not have a significant economic impact on a substantial number of small entities. The certification must be published in the Federal Register at the time that the general notice of proposed rulemaking or final rule is published.

(b) Except as provided in section 4c(3)(a), when an agency is required by section 553 of the Administrative Procedure Act, or any other law, to publish a general notice of proposed rulemaking for a rule, the agency must prepare and make available for public comment an initial regulatory flexibility analysis. The analysis or a summary of it must be published in the Federal Register at the time that the general notice of proposed rulemaking is published.

(c) Except as provided in section 4c(3)(a), when an agency publishes a final rule under section 553 after being required by that section or any other law to publish a general notice or proposed rulemaking, the agency must prepare and make available to the public a final regulatory flexibility analysis. A statement describing how copies of the final analyses may be obtained by the public must be published in the Federal Register at the time that the final rule is published.

(d) A copy of every initial regulatory impact analysis and of every certification statement must be sent to the Chief Counsel for Advocacy of the Small Business Administration.

(e) Those responsible for the preparation of a regulatory flexibility analysis should consult the Regulatory Flexibility Act and particularly sections 603 and 604 for information concerning what must be included in the analysis.

(4) Environmental Impact Assessments and Statements (EIA, EIS). Section 102(2)(c) of National Environmental Policy Act (NEPA) requires all Federal agencies to include in every

recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement on the environmental impact of the proposed action, adverse environmental effects of implementation and alternatives to the proposed action.

General (NEPA) requirements for EIA and EIS documents are set forth in 7 CFR 3100 and 40 CFR 1502. Agencies may have more detailed requirements applying to specific types of actions.

(5) Civil Rights Impact Analysis. When an Agency Head determines that a decision is "a major policy action having a significant civil rights impact", a civil rights impact analysis must be completed and, in addition to other clearances, the regulation and analysis must be submitted to the Assistant Secretary for Administration for review. Elements of the analysis include evaluation of impacts of the action, alternative approaches to minimize unfavorable civil rights impact and an equal housing opportunity assessment where appropriate. These requirements are set forth in Secretary's Memorandum 1662, Supplement 8, (June 28, 1976).

(6) Other Analyses Required by Law or Regulation.

d Notice and Public Comment

(1) General Policy. The Department is committed to providing the public reasonable opportunity to participate in rulemakings. For rules having a substantial effect, it is recommended that comment periods on proposed regulations be 30 days or more.

When an emergency or other good reason exists, a period of less than 30 days may be used. Regulations may also be issued on an emergency basis with no prior opportunity for comment if there is good reason not to solicit comment on the rule and the reason is set forth in the rule as published. The latter should generally be issued as interim rules and comments solicited following publication of the regulation.

OGC will determine the legal sufficiency of justification for an abbreviated comment period or for no comment period. This guidance is intended to make it clear that agencies have the flexibility to have less than a 30-day comment period or no comment period where action is necessary in shorter periods or where the nature of the regulation does not require a 30-day comment period.

(2) Regulatory Flexibility Act Notice and Comment Requirements. When any rule is promulgated which will have a significant economic impact on a substantial number of small entities, the head of the agency promulgating the rule or the official of the agency with statutory responsibility for the promulgation of the rule will assure that small entities have been given an opportunity to participate in the rulemaking for the rule through techniques such as the:

(a) Inclusion in an advanced notice of proposed rulemaking, if issued, of a statement that the proposed rule may have a significant economic effect on a substantial number of small entities;

(b) Publication of general notice of proposed rulemaking in publications likely to be obtained by small entities;

(c) Direct notification of interested small entities;

(d) Conduct of open conferences or public hearings concerning the rule for small entities; and

(e) Adoption or modification of agency procedural rules to reduce the cost or complexity of participation in the rulemaking by small entities.

e Memorandum of Law For Major Regulations. A memorandum of law prepared by OGC regarding the agency's authority to issue the regulation must be included in the Federal Register notice of promulgation of all major regulations.

If the selected alternative is not the lowest cost option as stated in the decision criteria in section 4c(1), the memorandum (as well as the Regulatory Impact Analysis) should explain any legal reasons why such alternative(s) could not be adopted.

f Memorandum Summarizing the Rule and Its Impact for Major Rules. This memorandum should be prepared by the agency for the Secretary and Deputy Secretary for each major rule and transmitted when the decision package is approved by the Agency Head.

g General Content Requirements for Federal Register Notices on Proposed or Final Rules. General requirements are set out in 1 CFR 18 and are discussed in detail in the "Document Drafting Handbook" available from the Office of the Federal Register. The appendix of this regulation provides a checklist useful in the preparation of proposed or final regulation documents.

h Rulemaking File. Agencies will maintain a file for each proposed regulation containing copies of all Federal Register notices regarding the regulation, background data on which the proposed regulation is based, analyses conducted by the agency, written or oral comments received from the public, transcripts of any meetings or hearings, written or oral comments from OMB and any other data which will be considered in the decision to promulgate the final regulation.

5 DEPARTMENT CLEARANCE PROCEDURES

a Requirements for All Regulations

(1) Agencies are responsible for preparation of regulations in accordance with this directive, instructions of the appropriate Under Secretary or Assistant Secretary, and other relevant requirements.

(2) OGC will review all regulations for legal sufficiency. Agency staff may wish to consult OGC during drafting to expedite the clearance process.

(3) OIRM will review regulations for information collection or recordkeeping requirements during the OMB review and public comment period, as appropriate. Agency staff may wish to consult with OIRM during drafting to expedite the clearance process.

b Special Requirements for Major Regulations. In addition to the requirements of section 5a, major regulations must be handled as follows:

(1) Agencies are responsible for preparation of Regulatory Impact Analyses, subject to the direction of the appropriate Under Secretary or Assistant Secretary.

(2) Major regulations and Regulatory Impact Analyses will be presented together in a single package, and be cleared in the following order:

(a) Agency Head;

(b) Office of Information Resources Management, signs only the regulation;

(c) Assistant Secretary for Administration, necessary only when there is a significant civil rights impact, signs only the analysis;

(d) Office of Budget and Program Analysis;

(e) Assistant Secretary for Economics, signs only the analysis;

(f) General Counsel, signs only the regulation; and

(g) Under Secretary or Assistant Secretary.

Reviewing officials should sign and date the salmon copy, stating name and title.

(3) Agencies will forward advance information copies of the clearance package to OIRM, OBPA, the Assistant Secretary for Economics, the General Counsel and the appropriate Under Secretary or Assistant Secretary in order to facilitate the clearance process.

(4) Agencies will forward a memorandum summarizing the regulation and its impact to the Secretary and the Deputy Secretary when the Agency Head has cleared the package. The Secretary and Deputy Secretary can then select those rules they wish to review. If they have not advised the Under Secretary or Assistant Secretary of their intention to review a regulation by the time the Under Secretary or Assistant Secretary has cleared it, the regulation may be transmitted to OMB without further review.

6 OMB CLEARANCE REQUIREMENTS

As required in the Executive Order, regulations subject to this directive must be submitted to OMB prior to publication in the Federal Register. The procedures follow:

a Documents Required for Regulations Clearing OMB. OMB requires submission of regulations in triplicate with each copy accompanied by a completed SF-83. The SF-83 must be signed by the "Program Official" for the agency, (normally the Agency Head, or his or her designee) and the "Authorized Regulatory Contact" (normally the responsible division director or regulatory management official of the agency). The agency must transmit to OBPA and to OIRM one copy of each proposal and final regulation, including the SF-83, when it is transmitted to OMB.

b OMB Clearance Timetable. OMB has:

(1) 10 days in which to review nonmajor regulations whether in proposed or final form;

(2) 60 days to review major proposed regulations (or final regulations if there was no proposed regulation) and Regulatory Impact Analyses; and

(3) 30 days to review major final regulations and Regulatory Impact Analyses.

c Notification of OMB Clearance. OBPA acts as liaison with OMB and will advise agencies of clearances of regulations.

7 REVIEW OF EXISTING REGULATIONS

Existing regulations are to be reviewed on an ongoing basis to bring about the goal of reduction of regulatory burdens and to minimize economic impact on small entities.

Under Secretaries and Assistant Secretaries are responsible for assuring that reviews are accomplished. The following requirements must be met:

a Regulatory Review Plans. Agencies will maintain regulatory review plans which establish priority areas for review, which identify major regulations, and which assure that all existing regulations are reviewed within a five-year period. These plans and changes or amendments to the plans must be approved by the appropriate Under Secretary or Assistant Secretary.

b Criteria for Review. Agencies will review regulations according to the following factors as well as such other factors as they believe are appropriate:

(1) The continued need for the rule;

(2) The nature of comments received concerning the rule from the public;

(3) The complexity of the rule;

(4) The extent to which the rule overlaps, duplicates or conflicts with other Federal rules, and, to the extent feasible, with State and local government rules;

(5) The length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the areas affected by the rule; and

(6) The extent to which there is opportunity to reduce governmental or nongovernmental burdens while still achieving statutory objectives and requirements.

c Conclusion of Review. The Agency Head will determine, on the basis of the review, whether regulations should be continued without change, revised, or rescinded. A rulemaking file shall be created for each review so that records can be maintained on the reviews and determinations.

(1) If the rule is to be continued without change, a notice shall be published in the Federal Register which briefly states that the review has taken place and the basis for the decision.

(2) If the rule is found to need revision or should be rescinded, the agency should initiate rulemaking actions, which are subject to the procedural requirements of this directive, including preparation of Regulatory Impact Analyses for major regulations.

8 USDA SEMI-ANNUAL REGULATORY AGENDA

The USDA Semi-Annual Regulatory Agenda is required by the Executive Order and the Regulatory Flexibility Act. OBPA will compile the Agenda for publication by the Secretary in April and October of each year. When the Agenda is published OBPA will distribute it to the Chief Counsel for Advocacy of the Small Business Administration, and to small entities or their representatives, or publications likely to be obtained by small entities as required by Section 602 of the Regulatory Flexibility Act.

FIGURE 1

AD-763 (7-81)

U.S. DEPARTMENT OF AGRICULTURE

WORK PLAN

DESIGNATION OF OVERSIGHT: *(Completed by Under or Assistant Secretary and returned to OBPA)*

☐ NON-MAJOR, AGENCY OVERSIGHT ☐ NON-MAJOR, UNDER/ASSISTANT SECRETARY OVERSIGHT ☐ MAJOR, UNDER/ASSISTANT SECRETARY OVERSIGHT	INSTRUCTIONS TO AGENCY AND/OR OBPA
SIGNATURE	DATE

DESCRIPTION OF CONTEMPLATED ACTION *(Completed by the Agency and sent to OBPA)*

DESCRIPTIVE TITLE

DESCRIBE OBJECTIVES OF, AND NEED FOR GOVERNMENT ACTION:

☐ CHECK IF REGULATORY FLEXIBILITY ANALYSIS APPEARS TO BE REQUIRED.

ALTERNATIVES AND EXPECTED EFFECTS: *Briefly outline the alternatives and summarize the expected effects of this action to the extent they are known at this time and attach on one single-spaced sheet.*

PROJECTED SCHEDULE *(Enter dates; if none planned, enter "none")*

PRE-NOTICE:	PROPOSAL:	HEARINGS/MEETINGS:	FINAL:

AGENCY CONTACT *(Name, mailing address, phone):*

DOCKET AND REGULATORY AGENDA NUMBER ☐☐ . ☐☐ ☐☐☐☐☐ Year Month Serial	AGENCY/OFFICE:	APPROVED FOR AGENCY *(Agency Head)*	DATE APPROVED

APPENDIX A

OUTLINE FOR PREAMBLE AND TEXT FOR NOTICE OF PROPOSED AND FINAL RULES

This outline is provided to serve as a checklist to be used in the preparation of Federal Register documents regarding proposed or final regulations. Items are listed in the order preferred, but not required. Not all items are necessary or appropriate for all types of regulations. Also, the extent of text used for each item should be tailored to reflect the importance and complexity of the action being taken.

Header Used by FR	Elements of the Entry
--	Billing code
--	Department name
--	CFR parts affected
--	Descriptive title
AGENCY:	Agency or staff office of the Department
ACTION:	Indicate the type of action. For instance, Notice of Proposed Rulemaking; Final Rule; Prenotice; Advanced Notice of Proposed Rulemaking; Notice of Meeting; etc.
SUMMARY:	Summarize the action (required by 1 CFR 18.12) by briefly describing: • The action being taken. • The circumstances creating the need for the action. • The objectives and effects of the action.
DATES:	State all relevant dates including any of the following: • Comments must be received on or before ______. (Period should be at least 60 days unless an emergency or other reason warrants a shorter period.) • Date and times of hearings or meetings and their locations. Coordinate this with the information in "Addresses," below. • Effective date (estimated for proposals; actual for finals).

ADDRESSES:	Identify all necessary addresses. If none, omit this entry. • Name(s) and address(es) to which comments should be sent. • Addresses of hearings and of individuals to contact for advance material, to place items on the agenda, to reserve space, etc.
FOR FURTHER INFORMATION:	Identify the name, title, mailing address and telephone number of a knowledgeable agency official whom the public can contact for further information. Indicate the availability of any analytic statements relating to the action.
SUPPLEMENTARY INFORMATION:	Assure that (1) legal statements required for this action are made, and (2) readers who are not expert in the subject area will understand the action. • State whether the rule is major or nonmajor and the reasons for the determination. • If the rule is major, briefly summarize the preliminary or final Regulatory Impact Analysis. • Certify the inapplicability of the Regulatory Flexibility Analysis requirement or indicate that it applies and whether an analysis has been conducted. • Indicate what other analytic requirements are applicable, if any. (For example, Environmental Impact Statement, etc.) • If the action is being issued as an emergency without prior comment or without any comment period, explain the reasons. • If the action is an emergency, explain the basis for that determination and, if the emergency is such that compliance with Executive Order 12291 is not practicable, the reasons why it is not practicable. • Explain the need for governmental action and the Department's objectives or alternative objectives with respect to the problem. • Summarize the major alternative actions considered, their technical and financial feasibility, and their expected direct and indirect economic, health, environmental and social effects. Identify the favored or final alternative, and reasons.

- Discuss the highlights of the action, clarify complexities, and draw the public's attention to new provisions, as appropriate.
- Make any statements about information collections in the regulations that may be required.
- For final major regulations, include the memorandum of law prepared by OGC as required by the Executive Order 12291, section 4(a).
- For final regulations, summarize comments received, if any, and USDA's response.

#

List of Subjects in Part ______ (CFR Index Terms)

Words of issuance (required if the signature appears before the text)

Text of Regulation or Action

- Amendatory language
- Table of Contents (if necessary)
- Authority citation
- Text

Identify in the text of the regulation the OMB control number for each information collection requirement mentioned. The number may be identified by placing it in parentheses where the requirement is mentioned or in such other manner as is clear and brief.

For all Federal or federally-assisted program announcements, indicate the official program number and title listed in the Catalog of Federal Domestic Assistance Programs, as outlined in OMB Circular A-89.

Signature--Note that major proposed and final actions must be signed by an Under Secretary or Assistant Secretary or above.

Mr. Robinson. Thank you, Mr. Franke.

At this time, I will yield to the majority counsel for any questions or views that he has.

Mr. Orban. Yes, Mr. Chairman.

I have heard from some of the other members of the subcommittee who, unfortunately, could not be here and who wanted to be here to ask some questions, that they would like to ask some questions.

Can you tell me, first of all, Mr. Franke, who is responsible at AMS for the decision not to do these analyses? What office or what person?

Mr. Franke. I would refer in my response to the departmental regulation that does list the internal management approach and, in order, the agency heads. It is my understanding, the agency head, Mr. Handley, that must sign off on these decisions and approaches; the Administrator of Agricultural Marketing Services.

Mr. Orban. Can you assure the subcommittee that he will respond to any written questions that may be submitted following this hearing?

Mr. Franke. Absolutely.

Mr. Orban. Then, Mr. Chairman, if it please you and the members of the subcommittee, could we hold the record open for 2 weeks for answers to our written questions?

Mr. Robinson. Without objection, so ordered.

I will now recognize the minority counsel.

Mr. Lynch. Thank you, Mr. Chairman.

In the Department of Agriculture's letter on the Regulatory Flexibility Act in December 31, 1980, the last sentence in the first paragraph is the important one.

It reads: "It", the act, "grew out of a concern that unduly burdensome requirements were being placed on the small business sector, as a result of Federal Government regulation, thereby hindering competition."

Obviously, the testimony we have heard before concerning the marketing orders centers around that question, and we are greatly concerned about that. Therefore, I would like to ask for a couple of things.

First, this is for the record, if we might. I would like a statement from your general counsel in Agriculture on whether or not marketing orders are subject to the Regulatory Flexibility Act and his legal reasoning for that.

Also, whether or not they are subject to Executive Order No. 12291.

Next, not necessarily for the record, but we would like to see it, on January 31, 1985, the prorate regulations for navel oranges was temporarily suspended, and the Economic Research Service of USDA did a study on that.

We would like a copy of that study to at least go over, if we could.

Then, I understand there was a followup report on the effects of that suspension which was due in October 1985, but I have been told has not yet been released.

We would also like to look at a copy of that, if that is available. If it is not available, we would like to know why it is not yet.

Mr. Franke. I will find out and so respond.

[See appendix, p. 387.]

Mr. Lynch. I would just like to say for the minority side, Mr. Chairman, that we may well want to call some agriculture witnesses at our later hearings, I think, on the subject of marketing orders. This is a very crucial question.

Mr. Franke. And, if I might add, and certainly I am sure that Congress is aware, that it is very difficult in many of these areas to achieve unanimity among any group, including small growers in many cases.

I probably know just enough about marketing orders to be dangerous. I would not want to comment any further, but I know that whether you are talking environmental issues, whether you are talking county commissioner roles, or whether you are talking a small business within or without agriculture, the question of equity and those kinds of things come up in developing unanimity. It has been a very difficult situation, and I understand that.

Mr. Lynch. We understand that.

Mr. Robinson. Thank you, Mr. Franke.

If there are no further witnesses, this concludes the Subcommittee on Exports' hearing on the Regulatory Flexibility Act.

[Whereupon, at 11:35 a.m., the subcommittee adjourned to reconvene subject to call of the Chair.]

IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT

THURSDAY, MAY 22, 1986

House of Representatives,
Subcommittee on Export Opportunities
and Special Small Business Problems,
Committee on Small Business,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:05 a.m., in room 2359-A, Rayburn House Office Building, Hon. Ike Skelton (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN SKELTON

Mr. Skelton. Let me welcome you all to the second in our series of hearings on the Implementation of the Regulatory Flexibility Act.

Today we are predominantly concerned with the FCC. Their work is familiar to the subcommittee and their rules and regulations have had a dramatic effect on the communications industry, particularly small businesses, over the past few years since deregulation.

In addition, we have a followup witness from the Department of Agriculture's Marketing Service to address some issues raised at a previous hearing.

These hearings serve a number of useful purposes. First, they inform us whether the agencies are doing what is required to carry out the intent and spirit of the laws we pass in Congress.

Second, they provide us an opportunity to compare the level of compliance in the various agencies and further to determine which management systems produce the desired analysis in the most effective way.

Third, they give the agencies and affected businesses the opportunity to share their opinions and experience with us about how the law should be applied and what problems have been raised.

Most importantly, it gives the members of this subcommittee and the Congress an opportunity to reflect on our policy and consider changes, if necessary.

The Regulatory Flexibility Act is the type of low-cost, commonsense program that I think represents the best, most beneficial work that this committee can do on behalf of every small business.

At this time I will recognize the chief author of the Regulatory Flexibility Act, and our colleague, Mr. Ireland, from Florida.

OPENING STATEMENT OF HON. ANDY IRELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. **Ireland**. Mr. Chairman, let me thank you again for conducting these oversight hearings on the Regulatory Flexibility Act. We are fulfilling our responsibility to see that this act is carried out. While we have had mixed reviews, for the most part, most agencies are complying with the act—with the spirit, as well as with the letter of the law.

The important thing is that when the law is followed, and with some enthusiasm, the small business community in the country profits tremendously, and I think all of us that sponsored the legislation and have worked to see that it is carried out can feel that we have done something for the entrepreneur in America.

Mr. **Skelton**. Thank you, Mr. Ireland.

At this time, I would like to call our first witness, today, Doris Freedman, from the Office of Advocacy, Small Business Administration.

Let me point out that the subcommittee is familiar with your work in this area regarding the monitoring of the Regulatory Flexibility Act; in putting together the annual report; and in helping our staff to prepare for these hearings.

Ms. Freedman, we thank you for your special effort, and we welcome you and your testimony.

At this time, I will notify you and all the other witnesses on the various panels that we have, that even though we are doing this by panel, we will urge you to keep your comments within 5 minutes, because there will be a number of questions, and we are under a pretty serious time constraint this morning.

With that in mind, and all witnesses having heard the admonition, Ms. Freedman.

TESTIMONY OF DORIS S. FREEDMAN, DIRECTOR, REGULATORY AFFAIRS, OFFICE OF ADVOCACY, SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC.

Ms. **Freedman**. Thank you very much, Mr. Chairman.

I appreciate your asking me to be here this morning for the continuation of your oversight hearings. The chief counsel could not be here today. It is Small Business Week, and he had some prior——

Mr. **Skelton**. He sent an excellent substitute.

Ms. **Freedman**. Thank you.

I have brought some extra copies of his testimony that he submitted last month which addresses the issues that I will raise today.

As Mr. Swain said last month, the congressional oversight that your subcommittee is providing is a big help in ensuring that agencies follow the Regulatory Flexibility Act. It is one of the best tools that we have to ensure that agencies listen to what we say when we file comments with them.

As you have heard repeatedly, Government regulation is a heavy burden for small businesses to bear, because of not only the paperwork and recordkeeping requirements—often the most readily apparent form of regulation—but also the changes the Government makes on how small business does business, or determining if small businesses can participate in certain kinds of businesses at all.

The necessity to perform a regulatory flexibility analysis for all these kinds of regulations is necessary if the best and most efficient regulatory scheme is to be adopted.

The Federal Communications Commission, by virtue of the nature of its mandate, imposes a very complex set of regulations on the communications industry, much of which is small business.

However, rather than be forthcoming with sophisticated analyses of the impacts of their regulation or seeking less burdensome ways to regulate small entities, we find that all too often the FCC seeks to avoid assessing the impacts of their actions.

As you will hear from the small business witnesses that follow me, they face real problems staying in business, or staying in business profitably.

I will address two kinds of problems relating to FCC rulemaking this morning. First, their attempt to define those they regulate as other than small businesses, and their conclusion that indirect impacts on small business do not require analysis.

The FCC has avoided regulatory flexibility analysis by attempting to exclude groups of small businesses from Regulatory Flexibility Act [RFA] coverage.

For example, the Commission has determined that small telephone companies are dominant entities in their areas, and, as such, are not small businesses as covered by the Regulatory Flexibility Act.

By making this finding, the FCC determined that they do not have to analyze their proposed rules as they relate to small telephone companies. This conclusion is not supported by the Small Business Administration regulations, which define dominant in the field.

Dominance is not geographical, as the FCC seems to imply from their findings. Rather, the SBA definition is as follows: "A concern is not dominant when it does not exercise a controlling or measurable influence on a national basis in a business activity, in which a number of business concerns are primarily engaged."

Small telephone companies are not dominant based on this definition.

In a variation to this approach of trying to define away small business, the FCC certified a rulemaking involving satellite license allocations as having no small business impact.

Since the proposed rule would eliminate all small business licensed applicants, the certification came despite the existence of small business license contenders, who, under the proposed rule, would have to demonstrate the ready availability of $300 million in cash, or credit, in order to keep their applications current.

The obvious problem created for small applicants by the proposed rule was dismissed by certifying that there was no small business impact, since, according to the Commission, no small business had $300 million.

Credit or equity financing, contingent upon the grant of the license, was not permissible under the proposed rule.

Since most of the smaller companies had planned to finance their ventures with revenues from the sale of satellite transmitting capabilities, the proposed rule eliminated the primary means by which members of this group could finance a satellite.

This rationale completely undercuts the purpose of the RFA. The Commission cannot propose a rule that would eliminate all small businesses from a given market, and then certify that it will have no effect on small business, merely because none will exist if the proposed rule becomes final.

In another FCC rulemaking, which had serious implications for hundreds of small resellers of WATS telephone service, the Commission failed to undertake an RFA analysis on the grounds that the proposed rule had no direct effect on small entities.

The conclusory dismissal of the RFA in a footnote to the proposal came despite extensive discussion within the text of the notice of proposed rulemaking, acknowledging the impact on small resellers, and detailing the reasons that resellers should pay higher prices.

The new rule imposed significantly higher access charges on resellers, meaning that a number of them will probably cease operations or, at the very least, witness a precipitous drop in profitability.

Despite the fact that a number of WATS resellers are small, the FCC did not undertake a small business analysis as required by the Regulatory Flexibility Act.

This decision was based on a prior determination that the act was not applicable, since the proposed rule would not directly affect any group that could be considered a small entity. What could be a more direct impact than substantially raising prices to an entire group of small businesses?

These were the kinds of problems that we are addressing with the FCC, to date not too successfully. These are the problems that the witnesses following me will bring up.

That concludes my prepared remarks. I will be happy to answer any questions.

Mr. **Skelton**. Thank you very much for your testimony. It is not only excellent; it is to the point!

Mr. **Skelton**. Mr. Ireland.

Mr. **Ireland**. Thank you, Mr. Chairman.

Could you tell me what response that advocacy gets from the FCC? Is it a stonewalling effect that you get from them?

Ms. **Freedman**. Not very much, to be perfectly frank.

Mr. **Ireland**. Well, is their reaction supported by an argument, or is it just "Look, we are a bigger deal than you are, and we are going to do it our way!" Or do they trot out all their legal forces?

Ms. **Freedman**. I think it is probably a fundamental disagreement of what is and what is not covered by the act.

I believe they read the act completely differently than we do. Again, rather than looking at the overall impact of their rules and how they could issue rules that help small businesses compete, they expend their efforts, I think, trying to define away the small business problem.

If you make the definition so that there are no small businesses that are covered by the rules, you can avoid the effect of the act.

We have filed, as you probably know, many comments with the FCC. We do get responses from them, either in the text of the final rule, saying how they addressed our comments, or sometimes by direct letter.

But we have never found that anything has changed because of our comments.

Mr. **IRELAND**. Do you ever suggest to them that most other agencies do not operate in the same way, and do not take that line of reasoning? Do they seem to think that they fly on a higher plane than other agencies in their interpretation?

Ms. **FREEDMAN**. We have raised that issue with them. You know, this is a Governmentwide program, and we have found good compliance in other agencies.

And I will say that when the FCC acknowledges that their regulations do have an impact on small business, they do do the requisite analyses. It is not that they fail to do them when they see there is a small business impact. In my opinion, they are, perhaps, too willing to find that there are no small businesses affected by what they are doing.

Mr. **IRELAND**. There are other areas where the FCC, compared to what it was 6, 8, 10 years ago, has made great strides in including many small businesses and opening up opportunities.

So, there is a paradox here. On the one hand, they are trying to help; on the other hand, there must be some part of the FCC that has not gotten the message. I wonder if you can pinpoint what it is in the FCC in this one regard——

Ms. **FREEDMAN**. No, sir; I cannot.

Mr. **IRELAND** [continuing]. Where the rest of it seems to be moving in the right direction.

Ms. **FREEDMAN**. No; I cannot pinpoint that.

Mr. **IRELAND**. Thanks very much.

Mr. **SKELTON**. Mr. Coble.

Mr. **COBLE**. No questions.

Mr. **SKELTON**. Mr. Cobey.

Mr. **COBEY**. No questions.

Mr. **SKELTON**. We thank you very much for your attendance.

Let me ask one quick question. We have heard the reticence of the FCC to comply. Would your group recommend additional teeth in the law to require them to comply, such as judicial review, or something even stricter than that?

Ms. **FREEDMAN**. Well, I certainly could make recommendations for changes in language. I think the act is a good one, and, although on some things—and people may differ—I think that there could be some language changes. This kind of oversight that this committee is holding is going to go a long way to making changes.

We have found that agency compliance with the Regulatory Flexibility Act always goes up near the time that we are publishing our annual report, so I think that that is a very effective tool.

Mr. **SKELTON**. You are obviously telling us that you do not feel that you have the teeth to compel compliance.

Ms. **FREEDMAN**. Well, the Office of Advocacy has no enforcement authority over these agencies.

Mr. **SKELTON**. I understand that.

Ms. **FREEDMAN**. Right; and so in that regard we cannot enforce compliance.

Mr. Skelton. If you had your druthers, would you change the law to put some teeth into it?

Ms. Freedman. Well, I mean, I would like to see the act work better.

Mr. Skelton. Right. I think you have answered it.

Thank you so much.

Mr. Ireland. Mr. Chairman.

Mr. Skelton. Yes.

Mr. Ireland. We have an amicus brief in the milk marketing case.

Ms. Freedman. Yes, sir.

Mr. Ireland. Could you, in that regard, bring us up to date? What is the status on that case?

Ms. Freedman. As we testified a month ago, the Office of Advocacy has filed an amicus brief in a court case in the Eastern District of Pennsylvania on the issue of milk marketing orders. That case is still pending; no decisions—nothing has been issued yet.

Mr. Ireland. No idea of anybody thinking they have won?

Ms. Freedman. No; in the inquiries that I have made the only thing that I hear is that it is going to take a long time. That is all I have heard.

Mr. Ireland. All right. Thanks.

Ms. Freedman. Thank you.

Mr. Skelton. Thank you so much.

Our next panel is Mr. Robert Fay, director of the Rock Port Telephone Co. of the great State of Missouri; Lorinda Ackley, president of the Taconic Telephone Co.; and Kenneth L. Lein, general manager of the Winnebago Cooperative Telephone Association.

Sir, would you tell us your name for the record?

Mr. Daniel. My name is Paul G. Daniel. I am regulatory counsel for NTCA. I am here with Mr. Fay.

Mr. Skelton. National Telephone Cooperative Association?

Mr. Daniel. Yes, sir.

Mr. Skelton. Mr. Fay, welcome.

TESTIMONY OF ROBERT H. FAY, DIRECTOR, ROCK PORT TELEPHONE CO., ROCK PORT, MO, ON BEHALF OF NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, ACCOMPANIED BY PAUL G. DANIEL, REGULATORY COUNSEL [NTCA]

Mr. Fay. Good morning, Mr. Chairman, and members of your subcommittee.

My name is Robert Fay, president of the National Telephone Cooperative Association [NTCA], and I am a director of the Rock Port Telephone Co. in Rock Port, MO.

With me today is Paul Daniel, who is an NTCA regulatory counsel.

Rock Port serves approximately 1,500 subscribers in northwestern Missouri. We have six employees. Our subscriber density, a figure which in the capital-intensive telephone industry is used to gauge feasibility, is six subscribers per route mile of telephone line. This is a very low number by industry standards.

Today I am speaking on behalf of NTCA, a national trade association which represents 450 small, independent cooperative and commercial telephone companies throughout rural America. We serve millions of subscribers in some of the most high-cost, sparsely populated areas of America. Our goal is to ensure that rural areas receive telecommunications services on par with those available to urban residents.

NTCA welcomes the opportunity to participate in this hearing, and to share our concerns about the FCC's failure to determine that small telephone companies are small businesses for Regulatory Flexibility Act purposes.

My comments are made in hopes that you can provide clarification to the FCC that the act includes small telephone companies in its definition of small business.

In the past, Federal agencies initiated rulemakings without considering the impact of such proceedings on small companies. Such action usually resulted in heavy administrative and financial burdens on these companies. In response to the complaints of small companies, Congress passed the Regulatory Flexibility Act in 1980.

The act was designed by Congress to alleviate the burdens on small companies by requiring Federal agencies to analyze the impact of their decisionmaking on small businesses.

The act is not achieving the purpose intended by Congress, however, because the Federal Communications Commission does not recognize small rural telephone companies as small businesses for the purposes of the act. Therefore, it makes no preliminary analysis of the impact of its decisions on them. The Commission states that we are not small businesses because we are dominant in our fields of operation.

As a result, FCC rulemakings such as Computer III and the Rate of Return Reporting Requirements proceedings, if adopted as originally proposed, have the potential to result in increased administrative and paperwork burdens on small telephone companies. Many of the rulemaking proceedings which are burdensome to small telephone companies were initiated to confront the problems which evolved as a result of the divestiture of AT&T and the Commission's effort to deregulate the telephone industry.

Attached to my statement is a more detailed summary of Computer III and the Rate of Return Reporting Requirements proceedings as examples of how FCC's failure to consider small rural telephone companies as small businesses would increase administrative burdens in spite of the act.

The Commission's original revision of the accounting rules would have greatly increased the reporting and administrative costs for small telephone companies. However, as a result of industry and congressional objections, the Commission adopted a modified version of the original plan. While we are pleased that the Commission modified some of its proposals so as to alleviate needless burdens on small companies, this 7-year-long proceeding is a prime example of a situation in which the act should have been applied. A good deal of time and money could have been saved by all parties involved if the needs and problems of the small telephone companies had been analyzed in the very beginning.

The FCC's position that small rural telephone companies are "dominant in their fields of operation" is inconsistent with the way the Small Business Administration interprets the term "dominant." The SBA "does not consider a business dominant if that business does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged." 13 CFR 121.3(c) (1985). The SBA generally considers a number of factors in determining whether a business is dominant: Number of employees, volume of business, financial resources, and competitive status. However, in the telephone industry, the agency only considers the number of employees in determining whether a telephone company is a small business. In a final rule issued March 15, 1985, the Small Business Administration declared that a telephone company employing 1,500 or fewer people is a small business. 13 CFR 121.2(c)(2), 50 FR 10495 (March 15, 1985).

Looking at the overall picture in the telecommunications industry, it can hardly be said that small, rural telcos are dominant. We lack any significant market power in the interstate access market. In fact, we are only a tiny portion of that market. We are not in a position to set rates or dictate terms and conditions. Most NCTA members serve under 30,000 access lines. The average number of employees is only 23 individuals. However, most of our companies are very small and employ just a handful of people.

In Rock Port we only have six employees. The average subscriber density for our members is six subscribers per route mile of telephone line. The larger companies operate in areas where the subscriber density is in the thousands, and not by route mile, but by city block.

The annual operating revenues of NTCA members range from $80,000 to $15 million. These figures do not touch the $57 billion reported by the 22 Bell operating companies in 1984.

NTCA members are not the only ones concerned about the increased adminstrative burdens on small telephone companies. Recently the United States Telephone Association [USTA] petitioned the Federal Communications Commission to institute a rulemaking regarding the regulation of small telephone companies. USTA also asked the Commission to find that small telcos serving 20,000 or fewer access lines are nondominant and to alleviate the regulatory burdens on small telcos which wish to file their own tariffs by relaxing the cost support data requirements of 47 CFR 61.38. USTA pointed out that their finding would be consistent with the congressional intent expressed in the Regulatory Flexibility Act.

NTCA supports the USTA petition and in comments filed March 31, urged the Commission to inquire into the matter. NTCA argued that the degree of strict regulation placed on small telcos serving 50,000 or fewer access lines should be relaxed because they do not have the staff or revenue flow to accommodate extensive regulation. Minimizing regulatory burdens avoids causing inappropriate or unnecessary increases in service costs which must be recovered from customers.

Telephone service in rural, high cost areas is particularly vulnerable at this point in the transition to a competitive telephone environment. The effects of deregulation and the subsequent FCC proceedings have greatly increased the administrative and paperwork burdens of small telephone companies. Many of the regulato changes comtemplated and implemented by the FCC are designed for large companies and imposed on small companies.

We urge this subcommittee to require the FCC to submit to the purpose of the Regulatory Flexibility Act and alleviate burdens on small telephone companies. Small telcos serving 50,000 or fewer access lines should be considered nondominant for the purpose of the act, and included in the act's definition of small businesses.

Congressmen, we at NTCA want to thank you and your subcommittee for your help on small business problems, especially for your help on the House Concurrent Resolution No. 308, which addresses the regulatory burdens on small telephone companies.

Thank you.

Mr. SKELTON. Thank you, Mr. Fay. I appreciate your being with us.

[Attachments to testimony follow:]

Attachment I

EXAMPLES OF FCC PROCEEDINGS IN WHICH REGULATORY FLEXIBILITY ANALYSIS SHOULD HAVE BEEN CONDUCTED

Introduction

These proceedings are FCC rulemakings which have the potential to profoundly affect small, rural telephone companies. These dockets were initiated with no prior regulatory flexibility study because the Commission considers all telcos dominant in their fields of operation and therefore not small businesses.

Rate of Return Reporting Requirements -- CC Docket No. 86-127

The Commission initiated this proceeding to propose the establishment of certain reporting requirements for the National Exchange Carrier Association (NECA) and those telephone companies which file individual interstate access tariffs. The purpose of this rulemaking is to establish a means by which the FCC can enforce its maximum rate of return limitations. The Commission acknowledged in its Notice of Proposed Rulemaking that the proceeding would impose new reporting burdens on affected telcos.

Concerns of Small Companies

o The Regulatory Flexibility analysis is particularly important in a case such as this one since the proposal, if adopted, would result in additional reporting burdens being imposed on all telcos filing individual interstate access tariffs. Small companies find it difficult to comply with regulations written for larger companies because they have fewer resources to devote to compliance.

- Small telcos already face significantly increased reporting requirements due to the advent of both interstate and intrastate access tariffs and the need to keep records of many new revenue, expense and investment items.

- Although tariff-filing telcos may be required to submit certain reports to the regulatory authorities, these requirements should not be made so burdensome so as to divert resources of these companies away from the performance of their businesses.

Third Computer Inquiry -- CC Docket No. 85-229

Computer III is the third proceeding in a series of related rulemakings in which the Commission: (1) identified services as being competitive or non-competitive offerings and (2) determined that non-competitive offerings would be subject to regulation.

In Computer I the FCC determined there was a clear distinction between "communications" offerings and "data processing" offerings and that only the former would be regulated.

In Computer II the Commission created new definitional terms: "basic" services would be regulated while "enhanced" services would not be regulated.

In Computer III the FCC proposed a regulatory framework which would examine the specific offerings of "dominant" carriers to determine whether the offering is identified as communications, ancillary-to-communications or non-communications. The degree of regulation would vary with the classification.

Concerns of Small Companies

- The FCC should not stifle the introduction of new and advanced telecommunications in rural areas. This would occur under the proposed regulatory scheme because this proposal could create a situation where "ancillary" offerings, such as answering machines or "non-communications" offerings, such as real estate or financial services, which are not now strictly regulated, would suddenly become subject to strict regulation. Small rural telephone companies need the flexibility to diversify to offset anticipated declines in revenue caused by deregulation and increased competition.

- The assumption that all local carriers are dominant is the thrust of Computer III. If Congress were to clarify that small telephone companies are not dominant and therefore small businesses, the FCC could not make this assumption. By looking at market power and bottleneck facilities, services which were exempted from regulation in Computer II would become subject to regulation under Computer III. Computer III is a step backward and would greatly add to the burdens already imposed on small telephone companies.

Mr. SKELTON. Lorinda Ackley, is that correct?

Ms. ACKLEY. Yes.

Mr. SKELTON. And you are from New York?

Ms. ACKLEY. I am from New York and Massachusetts.

Mr. SKELTON. Welcome.

Ms. ACKLEY. Thank you.

TESTIMONY OF LORINDA ACKLEY, PRESIDENT, TACONIC TELEPHONE CORP., CHATHAM, NY, ON BEHALF OF UNITED STATES TELEPHONE ASSOCIATION [USTA]

Ms. ACKLEY. Mr. Chairman, and members of the subcommittee. I am Lorinda Ackley, president of Taconic Telephone Corp. in Chatham, NY, appearing before you as a representative of the United States Telephone Association [USTA].

The Nation's local telephone companies are dedicated to two things: serving the Nation's telecommunications needs and maintaining universal service.

USTA members, large and small, firmly believe that, in order to maintain a healthy small business participation in the local telephone industry, the administrative and regulatory burdens on small telephone companies must be reduced.

This February, USTA asked the FCC to apply the Regulatory Flexibility Act to ensure that any new rules do not impose costly burdens on small companies.

My family has two small companies. Taconic Telephone serves approximately 18,000 customers in upstate New York, and Richmond Telephone Co. serves 750 subscribers in rural Massachusetts.

Streamlined regulation is appropriate because small companies lack power in the market regulated by the FCC. Our rates are constrained by the rates charged by the larger companies. Our lack of size prevents manipulation of rates to AT&T, which has the size and expertise to make its views known should there be any potential abuse.

Small companies are very dependent on the access revenues received from AT&T, and are not about to alienate them by setting high rates.

Congress adopted the Regulatory Flexibility Act to ensure that laws and regulations designed to apply to large-scale entities did not inflict costly burdens on small businesses.

The act requires agencies to explicitly consider alternate provisions in their rulemaking process, which can reduce the economic impact of a rule on small businesses.

To date, the FCC has concluded that small telephone companies cannot be considered small businesses because of dominance. We believe that small companies are not dominant in the long-distance access market, and clearly suffer from regulatory burdens.

We propose that small companies with under 20,000 subscribers be eligible for Regulatory Flexibility Act treatment. An example of streamlined regulation would be considering tariffs filed by small companies as lawful. Instead of all the data currently required, small companies would submit a brief statement setting forth the basic rates, terms, and conditions of service.

A small company could only qualify for this streamlined treatment if its proposed access rate is not higher than either of two standard industry rates.

This information should be adequate for the Commission to make an initial decision. The Commission will retain the authority to suspend and investigate a small company's tariff, and to request additional information when investigating a complaint.

The high cost of tariff-filing rules are a vivid example of administrative and regulatory burdens.

In New York, Taconic Telephone is spending $40,000 just to review whether we should file our own tariff. In Massachusetts, the Richmond Telephone Co. is also deciding whether to file a tariff. And the estimated cost is around $30,000.

In Wisconsin, out of 96 small telephone companies, none have filed their own traffic-sensitive tariff because of costs.

Two large Wisconsin companies, Bell and GTE, have a larger customer base over which to spread costs, and both have filed tariffs.

In Colorado, Strasburg Telephone Co. has spent $20,000, which amounts to over $22 per customer.

In Illinois, Moultrie Independent Telephone Co. has spent $19,000, over $29 per customer. They expect another $5,000 in costs soon.

These were the fortunate ones. K&M Telephone Co. of Nebraska, which has three full-time employees, attempted for a year to file their own tariff. After high costs and the frustration of encountering a blizzard of red tape, they abandoned the effort. K&M is convinced that, if they had continued, it would have ended up costing each customer $36 or more per year.

USTA is now working with the FCC to eliminate unnecessary burdens. The FCC has so far been cooperative, placing the USTA petition on a fast track. Should the process not continue to go forward, we would appreciate the opportunity to come before you again.

The Commission's position is not yet clear on classifying small telephone companies as nondominant in the interstate access market, allowing them Regulatory Flexibility Act treatment.

USTA supports the goals of the Regulatory Flexibility Act, and strongly believes that small telephone companies clearly suffer from the type of regulatory burdens the act is designed to redress.

In closing, I would like to read a letter sent to the FCC by Leaf River Telephone Co.:

> This is a letter, rather I should say a plea for the Federal Communications Commission to back the U.S. Telephone Association's Petition to Reduce Administrative and Regulatory Burdens on the Small Telephone Companies.
>
> I know that all companies were told that "Deregulation" was going to bring a "whole new ball game," but what everybody didn't know was that . . . it meant the increase of expenses of doing business in some areas that you can't believe. The most expense has been with the accounting firms, the cost consulting firms, billing companies, and lawyers. . . I think that this paper chase is ridiculous. It seems to me that anything that can be done should be done to help the small company that has only one person in the office . . . and try and wade through all this. . . The local subscriber is the one that has to pay for this "new era".

Thank you for your interest in small companies and their customers.

Mr. SKELTON. Thank you so much.

[Ms. Ackley's prepared statement follows:]

PREPARED STATEMENT OF LORINDA ACKLEY, PRESIDENT, TACONIC TELEPHONE CORP., CHATHAM, NY, ON BEHALF OF UNITED STATES TELEPHONE ASSOCIATION [USTA]

May 22, 1986

Opening Remarks

Mr. Chairman and Members of the Subcommittee, I am Lorinda Ackley, President of Taconic Telephone Corporation, Chatham, New York, appearing before you as a representative of the United States Telephone Association (USTA).

The nation's local telephone companies are dedicated to two things - serving the nation's telecommunications needs and maintaining universal service. USTA members, large and small, firmly believe that in order to maintain a healthy small business participation in the local telephone industry, the administrative and regulatory burdens placed on small telephone companies must be reduced.

Small telephone companies with under 50,000 access lines total only 3.2 percent of the nation's phones. Total subscribers of these 1128 companies is 3,675,479. My company, Taconic, has about 18,000 subscribers serving rural America and upstate New York. My family also owns the Richmond Telephone Company, with 750 customers in Massachusetts.

Summary of Recommendations

1. Small telephone companies are an important part of the telephone industry and must survive.
2. The cost of regulating small companies should not exceed the benefit.
3. Administrative and regulatory burdens should be reduced to allow better service to the public at lower cost.
4. The Congress should confirm that the Regulatory Flexibility Act applies to small local exchange telephone companies.

Goals of the USTA Petition to Reduce Regulatory and Administrative Burdens on Small Telephone Companies

On February 18, 1986 the United States Telephone Association filed a rulemaking petition with the Federal Communications

Commission. The Petition requested changes to the Commission's rules to relieve small companies of burdensome, unnecessary regulatory provisions. Specifically, USTA explained that the Commission's current tariff cost support provisions should not be applied to carriers serving 20,000 or fewer access lines, at a minimum, because the provisions impose excessive costs, cause inefficient use of the Commission's resources and fail to serve the public interest. USTA proposed that the smallest of the telephone companies be regulated as non-dominant carriers in the interstate access market and subject to less burdensome, streamlined tariff filing rules. The proposed changes will give small companies the option of filing their own traffic-sensitive access tariffs and provide them with flexibility necessary to compete in the post divestiture marketplace. Larger carriers have this flexibility now but small companies are effectively precluded from exercising flexibility because of the cost and administrative burdens associated with filing their own tariffs. USTA also asked that the Commission apply the Regulatory Flexibility Act to all future Commission proceedings to ensure that newly proposed rules do not impose unreasonable and costly burdens on small telephone companies.

Reasoning Behind the USTA Petition

USTA demonstrated in the Petition that streamlined regulations for small companies are appropriate because the targeted carriers lack significant market power in the interstate access market. This lack of power prevents the smaller companies from engaging in anticompetitive conduct, such as predatory pricing or cross subsidization. In addition, the rates charged for access by these companies are constrained by the rates charged by the larger companies. Thus, even though small companies operate as the sole provider of local exchange service in their designated service areas, they have no power in the interstate access market which is regulated by the FCC. Their lack of size prevents manipulation of access rates to AT&T. Quite the contrary, AT&T has the size, personnel and expertise to make its views known through the regulatory process, should there by any potential abuse.

Furthermore, small companies are encountering decreased support for their local facilities at a time of increased pressure to keep down local rates. Therefore, the small companies are very dependent on the access revenues received from AT&T and are not about to alienate this revenue source by setting unreasonably high rates. Smaller companies' lack of interstate market power warrants classification as non-dominant carriers. As sucn they would no longer be subject to the Commission's complicated and costly tariff cost support provisions.

USTA's Simplified Regulations Are Consistent With the Regulatory Flexibility Act

Congress adopted that legislation to ensure that laws and regulations designed to apply to large-scale entities did not unnecessarily inflict costly burdens on small businesses. The concern was that identical regulation of all businesses, regardless of size, would lead to an inefficient use of agency resources, enforcement problems and action inconsistent with the public interest. Therefore, the Regulatory Flexibility Act requires agencies to explicitly consider alternative provisions in their rulemaking process which can reduce the economic impact of a rule on small businesses.

To date, the Commission has concluded that small local telephone companies do not fall within the Act's definition of small business because of dominance at the local level. USTA believes, however, that small companies are not dominant in the interstate access market and clearly suffer from the type of regulatory burdens the Act is designed to redress. Thus, the Act should be applied in this instance and in all cases involving regulation of the small companies.

Tariff Filing Rules are an Example of the Need for Reduced Burdens

USTA proposed several changes to the Commission's Rules which streamline the tariff filing requirements for small telephone companies. These proposals are subject to modification based on actual experience. It may be that the 20,000 access line cutoff figure is too low and a higher number, perhaps 50,000, is more appropriate. As presently proposed, however, tariffs filed by small companies with 20,000 or fewer access lines would be treated as presumptively lawful. In lieu of support data currently required, small companies would submit, with each tariff filing, an information statement explaining the proposal and setting forth the basic rates, terms and conditions of service. A small company could only qualify for this streamlined treatment if its proposed access rate were no higher than either 1) the most recent available weighted average of the rates of the three largest non-Bell holding telephone companies with effective tariffs on file at the Commission or 2) the most recent effective rate established by the National Exchange Carrier Association (NECA) in its tariff.

The information provided by small companies under the streamlined regulatory treatment will be adequate for the Commission to make an initial determination as to a tariff's lawfulness. Market forces alone constrain the rate charged to keep it within a predetermined range of reasonableness. Furthermore, small companies will continue to be required to set rates that are just, reasonable and nondiscriminatory. Most importantly, the Commission will have the authority to suspend and investigate a small company's tariff, when necessary, and to request the submission of additional information when investing a complaint.

The tariff filing rules are a vivid example of the high cost of administrative and regulatory burdens.

- New York - My company, Taconic is spending $50,000 just to review whether we should file our own tariff.
- Massachusetts - Our small family company in Massachusetts, Richmond Telephone Company is also spending $50,000 to decide whether to file a tariff.
- Wisconsin - Out of 96 telephone companies in Wisconsin with under 20,000 access lines (averaging 3,000 access lines) none have filed their own traffic sensitive tariff because of the cost. Two large Wisconsin companies, Bell and GTE, have a larger customer base over which to spread costs and both have filed tariffs.
- Missouri - Fidelity Telephone Co. has spent over $10 per customer so far on consultants, attorneys and added telephone company staff.
- Colorado - Strasburg Telephone Co. has spent $20,000, which amounts to over $22 per customer.
- Kansas - Elkhart Telephone Co. has spent $30,000, which comes out to $22 per customer for them.
- Alabama - Bay Springs Telephone Co. has spent $170,000, over $23 per customer.
- Illinois - Moultrie Independent Telephone Co. has spent $19,000, over $29 per customer. They expect another $5,000 in costs soon.

These companies were the fortunate ones. K&M Telephone Co. of Nebraska, which has 3 full time employees, attempted for a year to file their own tariff. After high costs and the frustration of encountering a blizzard of red tape, they abandoned the effort. K&M is convinced that if they had continued with their attempt, it would have ended up costing each customer $36 or more per year.

The USTA Petition Benefits the Public Interest

Eliminating unnecessary regulatory provisions and reducing administrative costs for the Commission and small companies create cost savings which can be passed through to the rural customers served by the smaller telephone companies. In addition, the proposed changes will give small companies the increased flexibility of filing their own traffic sensitive access tariffs. This, in turn, leads to a more competitive environment and improved service to telephone customers.

USTA is now working with the FCC to eliminate these unnecessary administrative and regulatory burdens. The FCC has so far been cooperative, placing the USTA petition on a fast track. Should the process not continue to go forward, we would appreciate the opportunity to come before you again.

However, it is as yet unclear as to the position of the Commission on classifying small telephone companies as non-dominant in the interstate access market, allowing them Regulatory Flexibility Act treatment. USTA supports the goals of the Regulatory Flexibility Act, and strongly believes that small telephone companies clearly suffer from the type of regulatory burdens the Act is designed to redress.

In closing, a brief paragraph from a letter sent to the FCC by Leaf River Telephone Co. commenting on the USTA Petition is appropriate.

> "This is a letter, rather I should say a plea for the Federal Communications Commission to back the U.S. Telephone Association's Petition to Reduce Administrative and Regulatory Burdens on the Small Telephone Companies.
>
> I know that all companies were told the "Deregulation" was going to bring a "whole new ball game", but what everybody didn't know was that . . . it meant the increase of expenses of doing business in some areas that you can't believe. The most expense has been with the Accounting Firms, the Cost Consulting Firms, Billings Companies and the Lawyers. The fact that these different companies have more forms to fill out is not their fault but I think that this paper chase is ridiculous. It seems to me that anything that can be done should be done to help the small company that has only one person in the office or maybe two or try and wade through all this. It should be done and would be greatly appreciated. All different and new tariffs has brought such an additional expense on to the small companies that it has made the cost of operating for us up to such high cost that the local subscriber is the one that has to pay for this "new era".

Thank you for your interest in small telephone companies and their customers.

Mr. SKELTON. Mr. Lein.

TESTIMONY OF KENNETH L. LEIN, GENERAL MANAGER, WINNEBAGO COOPERATIVE TELEPHONE ASSOCIATION, LAKE MILLS, IA, ON BEHALF OF UNITED STATES TELEPHONE ASSOCIATION [USTA]

Mr. LEIN. Mr. Chairman, and members of the subcommittee.

I am Kenneth Lein, general manager of the Winnebago Cooperative Telephone Association of Lake Mills, IA, and I appear before you as a representative of the United States Telephone Association—that is the USTA.

USTA has over 1,100 telephone company members. All but the largest 32 are represented by the USTA Small Company Committee, of which I am a member. The average number of subscribers of these small companies is less than 2,000. Winnebago has a total of 6,300 subscribers.

USTA feels strongly about the following four points:

One, small telephone companies are an important part of the telephone industry and must survive.

Two, the cost of regulating small companies should not exceed the benefit.

Three, administrative and regulatory burdens should be reduced to allow better service to the public at lower cost.

And four, the Congress should confirm that the Regulatory Flexibility Act applies to small local exchange telephone companies.

Less regulation of small telephone companies has proven to be beneficial. Several States have acted to reduce the administrative burdens of small telephone companies.

Wisconsin has relaxed regulation for companies with up to 7,500 subscribers, and Illinois and Minnesota have done so for companies up to 15,000 subscribers.

However, I am most familiar with my own State of Iowa. Iowa is the home of 158 of the Nation's 1,128 small telephone companies serving less than 50,000 subscribers. Most of the Iowa companies are very small, with many having only a few hundred subscribers.

In 1963, Iowa passed a law saying that telephone companies with less than 2,000 subscribers and all cooperatives would be exempt from rate regulation by the Iowa Commission. This was so successful that it has been extended to companies with up to 15,000 subscribers. And that leaves only 7 or 8 rate-regulated companies in Iowa.

Iowa's small companies and cooperatives serve about 10 percent of the State's telephone subscribers. On the national level, all 1,128 small companies serve only 3 percent, a very small portion of the subscribers in the United States.

Although small companies in Iowa are exempt from the most burdensome State requirements, that does not mean that we are not responsive to our customers, or that we do not answer to the State Commission.

Service monitoring and a complaint procedure allows the Commission to ensure that subscribers are receiving good service at a reasonable cost. This balance of consumer, company, and regulatory interests has created an atmosphere conducive to the survival of small telephone companies in the State of Iowa.

Remember that the 158 Iowa companies represent over 10 percent of the companies in the Nation. Small companies are regulated more effectively by their directors and subscribers than they ever could be by regulators in the State capital, or by Federal regulators housed hundreds of miles away from Iowa.

Directors of small telephone systems who set the rates are either elected by their subscribers or are neighbors with their customers. Customers are readily aware of the neighboring rates, and find their own directors very accessible and very sensitive to community needs.

The manager of the local telephone company lives in the community, and customers know him personally. The cooperative which I manage, Winnebago, has only 24 employees to run a system with over 6,000 customers, 17 exchanges, and 1,249 route miles of line.

In a rural area like ours, characteristic of the areas served by many small companies, we have less than 5 customers per route mile. That adds up to a lot of windshield time for our employees. The last thing they need is to be sitting in an office, filling out complex and unnecessary forms.

Where fewer customers are available to absorb costs, each one must pay a larger share. A greater burden placed on small telephone companies discourages them from remaining in the industry. The loss of these small businesses, our Nation's small telephone companies, is being accelerated by the proliferation of regulatory burdens.

The experience in Iowa has national implications. It shows the benefits of recognizing the needs of small business.

The USTA petition to the FCC requesting less burdens on small telephone companies by applying the Regulatory Flexibility Act does the same thing.

There has been a deluge of new requirements on small telephone companies since the AT&T divestiture. We had infrequent contact with FCC prior to January 1, 1984. Now, the new procedures threaten to engulf small telephone companies with stacks of unnecessary paperwork. This flood of new burden seems to be increasing.

Recent rules and proposals in the area of accounting and reporting have created a worrisome future for the efficient operation of small telephone companies.

USTA is attempting to stem this tide of red tape and return the management and employees of small systems to their original and important goals, serving the Nation's telecommunications needs, and maintaining universal service.

The Regulatory Flexibility Act was intended to promote this goal, and it should be applied to small companies.

Thank you for your interest in the small companies and their consumers.

Mr. Skelton. Thank you so much, Mr. Lein. We appreciate your being with us.

[Mr. Lein's prepared statement follows:]

PREPARED STATEMENT OF KENNETH L. LEIN, GENERAL MANAGER, WINNEBAGO COOPERATIVE TELEPHONE ASSOCIATION, LAKE MILLS, IA, ON BEHALF OF UNITED STATES TELEPHONE ASSOCIATION [USTA]

May 22, 1986

Opening Remarks

Mr. Chairman and Members of the Subcommittee, I am Kenneth L. Lein, General Manager of the Winnebago Cooperative Telephone Association, Lake Mills, Iowa, appearing before you as a representative of the United States Telephone Association (USTA).

USTA represents over 1100 member companies, including the Bell Operating Companies. Together, USTA members provide 99% of all access lines in the U.S. through firms ranging from publicly-held corporations listed on the New York Stock Exchange to family-owned companies or companies like Winnebago, those owned by their customers.

All but the largest 32 companies in USTA are represented by the USTA Small Company Committee, of which I am a member. The average number of subscribers of these small companies is 1,915. Winnebago has a total of 6,300 subscribers.

Summary of Recommendations

1. Small telephone companies are an important part of the telephone industry and must survive.

2. The cost of regulating small companies should not exceed the benefit.

3. Administrative and regulatory burdens should be reduced to allow better service to the public at lower cost.

4. The Congress should confirm that the Regulatory Flexibility Act applies to small local exchange telephone companies.

Less Regulation of Small Telephone Companies Has Proven to Be Beneficial

Several states have acted to reduce the administrative and regulatory burdens on small telephone companies. For example, Wisconsin has relaxed regulation for companies with up to 7,500 subscribers, Illinois and Minnesota have taken action covering companies serving up to 15,000 subscribers.

However, I am most familiar with the reduction of administrative and regulatory burdens in my own state of Iowa.

Iowa is home to 158 of the nation's 1128 small telephone companies serving less than 50,000 subscribers. Most of the Iowa companies are very small, with many having only a few hundred subscribers.

In 1963, Iowa passed a law which provided that all small telephone companies (those with less than 2,000 subscribers) and all cooperative or mutual telephone companies would be exempt from rate regulation by the Iowa State Commerce Commission. The success of this law can be amply demonstrated by the fact that it has been extended from systems with less than 2,000 subscribers to now cover companies with up to 15,000 subscribers.

The 5 telephone companies which remain subject to rate regulation in Iowa count as customers approximately 90 percent of the state's telephone users. The 158 small companies and cooperatives serve the remaining ten percent of Iowa's subscribers. They provide communities and rural areas with reliable telephone service at a reasonable cost. Similarly, on the national level, the mid-sized and large telephone companies have 96.8% of the subscribers and all 1128 small companies under 50,000 access lines have only the remaining 3.2%.

Less Burdens Does Not Mean Total Deregulation

Although small companies and cooperatives in Iowa are exempt from the most burdensome state regulatory requirements, that does not mean that we are not responsive to our customers, nor does it mean we are not answerable to the state Commission for our actions. Quality of service monitoring and a complaint procedure allows the Iowa State Commerce Commission to ensure that subscribers are receiving good service at a reasonable cost while minimizing regulatory and administrative burdens. This balance of consumer, company and regulatory interests has created an atmosphere conducive to the survival of small telephone companies in the state of Iowa.

Small telephone companies in Iowa are regulated more effectively by their officers, directors and subscribers than they ever could be by regulators in the state capital, or by Federal regulators housed hundreds of miles away from Iowa. Officers and directors of small telephone systems who set the rates are either elected by their subscribers or are neighbors with their customers. Proximity to companies who are formally regulated also serves as a constraint since consumers are readily aware of neighboring rates and find their own manager and directors very accessible and very sensitive to community needs. In most cases, the manager, directors and employees of the local company live in the community they serve and 90 percent of their customers know them personally.

What It Would Be Like in Iowa With Full Regulation for All Companies

Full regulation for all companies before the Iowa Commission would require formal hearings, an expensive procedure. For most companies, formal hearings would require the hiring of additional, high priced, professional personnel: CPAs, engineers, and attorneys specializing in telephone utility regulation. Not only would unnecessary costs be imposed upon companies, but the Iowa

Commission would be subject to a vastly increased workload with a negligible benefit. Commission resources are better focused under lessened small company regulation.

Actual preparation time by company personnel is a significant cost to be added to the total expense of formal rate hearings. The cooperative which I manage, Winnebago, has only 24 employees to run a system with over 6,000 customers, 17 exchanges, and 1,249 route miles of line. In a rural area like ours, characteristic of the areas served by many small companies, we have less than 5 customers per route mile. That adds up to a lot of windshield time for our 24 employees. The last thing they need to be doing is sitting in an office filling out complex and unnecessary forms to comply with overly burdensome regulations. The inefficient use of employees time, as well as other costs previously mentioned, is paid directly by the telephone company and must eventually be passed along to the consumer.

Administrative and Regulatory Burdens are Detrimental to the Consumer and to Small Business

Subscribers realize that where fewer customers are available to absorb costs, each individual consumer must pay a larger share. The proportionately greater burden placed on small telephone companies is a strong disincentive to remaining in the industry. The loss of these small businesses, our nation's small telephone companies, is being accelerated by the burdensome administrative and regulatory tasks with which small telephone systems are increasingly being required to comply.

National Implications of the Iowa Experience

The experience in Iowa with lessened regulatory burdens for small companies demonstrates the benefits of an approach which recognizes the special needs of small business. The USTA petition to the Federal Communications Commission, requesting a reduction of the administrative and regulatory burdens on small telephone companies by the application of the Regulatory Flexibility Act, applies the same concept.

The USTA petition specifically requests relief from onerous tariff filing requirements to recover traffic sensitive costs. However, this is but one minor example of the deluge of new requirements small telephone companies have had to endure since the AT&T divestiture. Small companies had infrequent contact with the FCC prior to January 1, 1984. Now the new procedures surrounding the changing telecommunications environment threaten to engulf small telephone systems with stacks of unnecessary paperwork, most of it federally mandated. This flood of new administrative burdens seems to be increasing, not receding.

Administrative and Regulatory Burdens are an Ongoing Problem

Recent rules and proposals in the areas of accounting, rate of return reporting, separation of regulated and unregulated lines of business, and ability to employ average schedules of costs instead of doing expensive studies, have created an ominous future for the efficient operation of small telephone companies. USTA, through its petition to relieve burdens on small companies and through comments on other actions, is attempting to stem this tide of red tape and return the management and employees of small systems to their original and important goals, serving the nation's telecommunications needs and maintaining universal service.

Conclusion

There is no justification for procedures which raise telephone rates to consumers, force small telephone companies to employ additional personnel, and discourage the presence of small businesses in the local telephone industry. Unreasonable administrative and regulatory burdens benefit the consumer neither in savings nor in better service. No system is beneficial which increases inefficiencies by forcing a company to devote a larger percentage of its man-hours to non-productive efforts.

Although many regulatory body procedures are intended to protect consumers from unfair rates, they actually have just the opposite effect. They assure rising costs for both telephone companies and consumers alike. The Regulatory Flexibility Act was intended to prevent these unfortunate consequences, and it should be applied to small telephone companies.

A letter to the FCC from the West River Mutual Aid Telephone Corporation of Hazen, North Dakota eloquently states our position. After almost 2 years of expensive and time consuming effort, West River's access tariff was finally approved by the FCC on May 1, 1986. The General Manager of West River said the following "This was very costly to our small company, and universal telephone service would have been better served if we could have used this money to improve telephone service at reasonable rates in rural North Dakota."

Thank you for your interest in small telephone companies and their consumers.

Mr. SKELTON. Mr. Ireland.

Are you testifying also, sir?

Mr. DANIEL. No.

Mr. IRELAND. Thank you, Mr. Chairman.

I think each of you pretty graphically outlined the nature of the problem here.

If each one of you could examine your relationship to the FCC as you bring these problems that you have stated, or any others, to them.

Let me tell you why I ask that. The FCC in a number of areas, as I alluded to when Ms. Freedman was here, has done a reasonable job of cutting down paperwork, and this is such a glaring problem area that I think that you showed, I am wondering whether it is just a part of the FCC, or an unawareness of a particular industry, or what.

It would help me if you would tell me the kind of relationship you have when your organization, or your company approaches the FCC along this line.

Could you give me a feel for that?

Mr. FAY. Well, I would say this: The FCC is regulating our small companies, and they are looking at us with the same eyes that they are looking at the large companies; and we are nothing like the small companies, as far as regulation and all is concerned; and, as far as the pile of paperwork, there is no way that we can handle this without adding to the cost of each individual subscriber's telephone rate.

Mr. IRELAND. I understand, and I think each of you have made that point, I think, very clearly, and have substantiated your reasoning along that line.

What I am wondering more particularly, is, are these field representatives from the FCC, or is your communication to the FCC not doing the job?

Are you getting to the highest levels of the FCC, or are you just getting to low-level, bureaucrats?

Mr. FAY. Mr. Ireland, may I refer this question to our regulatory counsel, and he can answer that better than I can, out in Missouri.

Mr. IRELAND. OK.

Mr. DANIEL. Thank you, Mr. Ireland. My job involves writing comments, and dealing with the Commission on a daily basis, and reading orders and things that they bring out.

What we do is, every time we can, and every time it is appropriate, bring to the Commission's attention the Regulatory Flexibility Act issue, stating that small telcos are, in fact, not dominant, under the terms of that act, and asking them to perform the analysis.

To date, the FCC has not done it, simply referring back to a 1980 decision, the Competitive Carrier Rulemaking, I believe it is, where they decided that small telcos were dominant, because of joint provision of toll with the Bell System.

Well, the Bell System does not exist any more. There is no more joint provision of toll, so it seems time for a relook at it. We are bringing this to their attention. We have a case pending before the United States Court of Appeals for the District of Columbia Circuit on the Regulatory Flexibility Act issue. We have filed comments several times.

Other types of comment with the Commission would include lobbying efforts, going over and talking with individual members.

Mr. **Ireland**. Let me interject right there. You have mentioned the Commission, the FCC, their attention and, as I say, I totally agree with what you are trying to do. I am sold on it, and I see the results of it.

When you say the Commission, has this gotten the attention of the Commissioners themselves, or are you talking of some staff people down below that have got a badge on and want to exercise some authority?

It makes a difference to me, whether you are talking to the Commissioners themselves that seem to me are the kind of people that understand this, or some staff person that wants to be a big deal, and delay the process.

Mr. **Daniel**. I think we are primarily dealing with staffers, but awareness of the problem is penetrating to the Commissioners' level. They are beginning to understand. To the Commission's credit, they are taking efforts, at times, in proceedings, to recognize small companies as a separate entity. The problem is they are not doing it from the very beginning. They are not doing a Regulatory Flexibility Act analysis, and only after much pain and suffering——

Mr. **Ireland**. Why do you think they are not doing it?

Mr. **Daniel**. Because, as I think Mr. Lein pointed out, there is some relative inexperience with small telephone companies.

Mr. **Ireland**. Then, this is all at the staff level, then?

In other words, you are not getting to the people that are——

Mr. **Daniel**. No, sir——

Mr. **Ireland** [continuing]. Really capable of understanding this kind of thing.

Mr. **Daniel**. I think it is throughout.

I deal with the Commission more as a bulk—groups of people—and not separate staff from Commissioners.

Mr. **Ireland**. Well, that was what I am afraid of.

Mr. **Daniel**. I think the Commission is learning. We have only had 2 years since we moved to access tariffs and breakup of the Bell System. And, after 100 years of providing telephone service in the old way, moving to a new system takes some learning time.

So, the Commission is learning. I think it is a slow process. I think they would have helped themselves, had they done regulatory flexibility analysis in proceedings like Computer III.

Mr. **Ireland**. In other words, they would have helped themselves if they had followed the law?

Mr. **Daniel**. [Laughter.]

Mr. **Ireland**. I appreciate your testimony. It is very clear, and I thank you very much, Mr. Chairman.

Mr. **Skelton**. Mr. Coble?

Mr. **Ireland**. Excuse me.

Do either of you have any comment on that same thing?

Mr. **Lein**. Oh, yes; Mr. Ireland, just a followup.

I tend to agree with that. I believe that it is possible that the Commission has decided some issues on the dominance theory and did not apply the Regulatory Flexibility Act in the past that now should apply to small telephone companies. It may be difficult for them to change and to now apply that. I think they are worrying about that.

Ms. **Ackley**. I would just like to comment that we do get up to some of the Commissioners, and I think that they are beginning to recognize the problems the small companies are having, because of the recent dockets that have come out. They are asking comments from small companies, and are asking for input from them.

Mr. **Ireland**. Thank you.

Mr. **Skelton**. Thank you.

Mr. Coble.

Mr. **Coble**. Thank you, Mr. Chairman.

I, too, appreciate you all having appeared before our subcommittee this morning.

Mr. Lein, you mentioned in your opening remarks that cost should not exceed benefits. How about elaborating a little bit more about that, or giving me an example where the cost exceeds the benefits?

Mr. **Lein**. We made an informal study late in 1985, among 10 or 15 small companies across the United States. We added up the regulatory burden, the paperwork burden, the filing and reporting with NECA, and with FCC, and with others, and it was about $3.50 per customer per month.

And there are no benefits that can make up for that $3.50. It is simply an economic question, and that has been proven in Iowa many times over. Our rate cases before detariffing in Iowa were running small companies $25,000–$30,000. When a company had 500–600 access lines, there was no way that the benefits could equal cost.

Mr. **Coble**. I assumed that was what you were talking about, but I wanted you to lay that out with more detail. Thank you.

Thank you, Mr. Chairman.

Mr. **Skelton**. Let me ask, each of you, your opinion.

In dealing with the FCC, do they directly or indirectly agree that the Regulatory Flexibility Act applies to your companies in dealing with them?

Mr. Lein.

Mr. **Lein**. Mr. Skelton, I think that it is clear that they agree that the Regulatory Flexibility Act does not apply to our small companies.

Mr. **Skelton**. Do you agree with that?

Ms. **Ackley**. Yes; I would.

Mr. **Skelton**. Mr. Fay.

Mr. **Fay**. I echo that, yes.

Mr. **Skelton**. All right. Now, is this based upon a law suit, the 1980 law suit that is now in the court of appeals, or are there other indicia of this?

Counselor.

Mr. **Fay**. It is not on the law suit, per se.

Would you like further elaboration on that?

Mr. **Skelton**. Yes; please.

Mr. **Fay**. I would call on our counsel.

Mr. DANIEL. Your Honor, the 1980 case I referred to was an FCC proceeding looking at competitive carriers, the MCI's and SPRINT's of the world; and what the Commission, I think, was trying to do was separate out those carriers from the Bell System and their associated carriers.

Mr. SKELTON. But that was before Judge Green got a hold of things?

Mr. DANIEL. It was not before the antitrust case started, which commenced in 1974; it was well before.

Mr. SKELTON. It was before the decision?

Mr. DANIEL. Yes, sir.

Mr. SKELTON. So, it really would not apply?

Mr. DANIEL. That ruling, or that aspect of that case, I don't believe would apply now, sir; no, sir.

Mr. SKELTON. Fine.

We have some other interesting witnesses. We thank you so much for making the trip down. We appreciate it more than we can tell you.

The next panel, Mr. Dennis Dundon, president, A.C. Teleconnect; and Mr. Ron Mellon, Telephone Communications Corp.

Gentlemen, let me tell you this. We are under time constraints. You may not have heard my comment earlier. We would urge you to hold your testimony to 5 minutes each. Feel free to introduce your full testimony at length. It will be included in the record, because it does leave time for questions, and we also have some other witnesses following you, not to say the least, the Chairman of the FCC himself will be here, so we want to have some time for him.

Mr. Dundon.

Mr. DUNDON. Thank you, Mr. Chairman.

Mr. SKELTON. Mr. Mellon.

Mr. MELLON. Mr. Chairman.

Mr. SKELTON. Would you like to introduce the other folks that are with you.

Mr. DUNDON. Yes, sir; I will.

TESTIMONY OF DENNIS B. DUNDON, PRESIDENT AND CHIEF OPERATING OFFICER, A.C. TELECONNECT CORP., ROCHESTER, NY, ON BEHALF OF COMPETITIVE TELECOMMUNICATIONS ASSOCIATION [COMPTEL], ACCOMPANIED BY JACK DAVIDSON, VICE PRESIDENT OF OPERATIONS AND REGULATORY AFFAIRS, AND MITCHELL F. BRECHER, COUNSEL, ALC COMMUNICATIONS

Mr. DUNDON. Mr. Chairman, thank you. It is a pleasure to be here today.

I have with me today Mr. Brecher, who is counsel for ALC Communications, and who is working with our trade association, the Competitive Telecommunications Association.

Also with me today is Mr. Jack Davidson, who is our vice president of operations and regulatory affairs, and who may be available to answer questions that are pertinent.

I come before you today, first of all, as a small business representative; second, as a representative of an industry made up of small businesses.

The resale common carrier industry is only 5 years old. It is comprised of a number of small entrepreneurial companies that came into existence to provide low-cost telecommunications service to areas that were not adequately served by other carriers, namely the small cities and rural areas.

As you can appreciate, as the OCC market developed—those are the companies like MCI and SPRINT who are building their national networks—it was important for them to hit the major population centers.

Resellers, on the other hand, were concentrated in the smaller cities and towns, places where there was no alternative low-cost telecommunications service to AT&T; and we believe—and it is pretty clearly borne out by our experience in serving our customer base—that we were very successful in bringing some important benefits to those customers.

Resellers innovated in several different areas. We were the first to offer call completion to all areas of the country.

Second, we offered our customers accounting code features for the benefit of cost control within their businesses.

And third, we brought a very convenient travel service to the customer base.

We provided other small businesses with meaningful access for the first time to low-cost long-distance service, targeting specific pricing plans and procedures that would be of benefit to small businesses.

As an industry and a company, we are profoundly affected by the FCC, not because we are closely regulated, because that really applies to the dominant carriers. And you have heard a good deal of testimony already today on that topic.

Those carriers exercise market power, and have control, because of size or position in the distribution channel over some aspects of the market.

As a group, we have minimal overall market share. We offer no monopoly services, and we control no bottleneck facilities, like local exchange service.

So, how are we affected?

Well, principally, the FCC serves as the Government's implementer of public policy in telecommunications. And the FCC's opinions carry great weight, both with the investment community as well as with the consuming public.

The FCC appears to believe that ultimately the long distance industry must become an oligopoly of large companies. To the contrary, I vigorously believe that smaller regional carriers, like ourselves, if well managed, can not only survive, but prosper.

But the FCC's pronouncements have a chilling effect on the ability of small business to raise the necessary capital to grow, and can make customers reluctant to deal with small businesses because of the perception that you might not be here next year.

That is the first way in which the FCC affects our business.

The second is that we buy essential services from the dominant carriers, the BOC's and AT&T, who are regulated under policies, rules and procedures that are submitted to or dictated by the FCC.

Obviously, the FCC is subject to the Regulatory Flexibility Act, which we believe obligates it to meaningfully consider the impact of its decisions and actions on the Nation's small businesses.

Mr. Ireland earlier observed that there is both a letter and spirit to the act, and we certainly concur with his comments.

But I am unaware of any specific consideration given by the FCC to the impact of its decisions, specifically on my small business, or on our members in the resale common carrier industry.

Frequent changes in rules or procedures make business planning a complete nightmare. One quick example which is developed more fully in my prepared remarks, refers to the access charges that Ms. Freedman observed earlier were now going to apply to WATS resellers.

In the past year, there were two separate decisions by the FCC that changed the rules under which those charges would be applied, not the charges themselves, but specifically the rules and procedures under which we would pay them.

We believe that the most recent changes may increase A.C. Teleconnect's costs some $675,000 a year. That is fully a third of the $2 million in access charges that we paid in 1985. They are implemented on a short leadtime, and it requires network reconfigurations which take months to plan, procure, and implement.

Did the FCC consider the impact on my company as a small business? I think not. It responded to its own views and those of the BOC's, which have been the clear beneficiaries of divestiture.

There are some other examples. Specifically, the change in WAT's pricing, which is developed in my prepared remarks, which could cost us an additional $200,000 a year, again requiring network reconfiguration to ameliorate. And I ask the same question: Did the FCC consider the impact? I think not.

Another point, which is developed, is the inequality of equal access. There appears to be a perception on the part of the FCC that with the availability of equal access, or so-called Feature Group D service in a local exchange office, that brings full competitive parity.

I think that the examples that are listed in my remarks will show you very definitely that that is not the case. While the FCC is charged with transition management, the process is flawed. The most important consideration, providing very good service and a very smooth transition to the customer who is affected by this change, is not taking place.

Customers are not getting to the carrier whom they selected as of the cutover date; and the accomplishment of the equal access transition on an office-by-office basis, rather than on a regional basis, gives us great difficulty both in our network planning, and also in our marketing efforts. And I think you have all heard those remarks before.

In summary, I would ask the following: We do not seek protection from competition. As a matter of fact, we are in business to compete very vigorously. We do want the FCC to be concerned about the impact of its actions on small business. I think that is critically important, as the Regulatory Flexiblity Act requires.

Second, I would sure like Congress to ensure that the transition management as accomplished by the FCC, or as undertaken by the

FCC, is being handled in a consistent fashion, is being handled with the goal of establishing an overall competitive marketplace in long-distance communication so that the long-term benefits of competition can be achieved.

I do not think that we should proceed as the Federal Communications Commission seems wont to do, to deregulate the giant AT&T until Congress is satisfied that the ability to compete fairly is in place for our industry.

Thank you very much. I will be happy to answer any questions you may have.

Mr. SKELTON. Mr. Dundon, thank you very much.

[Mr. Dundon's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF DENNIS B. DUNDON, PRESIDENT AND CHIEF OPERATING OFFICER, A.C. TELECONNECT CORP., ROCHESTER, NY, ON BEHALF OF COMPETITIVE TELECOMMUNICATIONS ASSOCIATION [COMPTEL]

A. Introduction

My name is Dennis Dundon and I am President and Chief Operating Officer of A.C. Teleconnect Corp., a telecommunications company headquartered at 39 State Street, Rochester, New York. My company is a member of the Competitive Telecommunications Association (COMPTEL) which represents over one hundred small telecommunications companies nationwide, and they have assisted in the preparation of this testimony.

It is a pleasure and an honor to be able to come before you today to provide the Subcommittee with some background knowledge about an industry segment principally composed of small businesses - the competitive long distance resale industry - an industry which, through its existence, provides substantial benefits to consumers, including other small businesses. While my company is not closely regulated by the Federal Communications Commission (FCC), we are profoundly affected by the directions and decisions of that Commission. I will give some examples of those effects later in my remarks.

B. Background of Long Distance Resale Industry

Competitive long distance telecommunications has been around since the mid 1970's, principally as a result of the FCC's 1969 MCI decision and its 1971 Specialized Common Carrier decision. Although there was some dispute as to the scope of long distance services which could be provided on a competitive basis, that uncertainty was resolved in 1977-78 as a result of the Execunet litigation where the Court of Appeals held first that alternative carriers were entitled to provide switched (i.e. message toll and WATS - type) services as well as private line services and that the local exchange telephone companies including those owned by AT&T, must provide to those alternative carriers the local connections needed to enable them to offer their services.

Thus, Other Common Carriers (OCCs) were able to use their own, limited communications networks to carry long distance calls for the public. This gave great impetus to OCCs like MCI and Sprint (at that time an affiliate of Southern Pacific Railroad) who were continuing to build their own networks around the country.

As you can appreciate, it takes a tremendous amount of capital and time to build a microwave network cross-country. So these early OCCs concentrated on building and providing service only to major population centers like New York, Chicago, Los Angeles, and Dallas. The rest of the country continued to have access only to AT&T's long distance service.

Beginning in June, 1981, the FCC allowed the resale of AT&T WATS services to the general public on a per-call basis. It is reasonable to assume that this action was taken in response to well-defined long-run telecommunications policies. Companies like mine, called "Resale Common Carriers" could buy bulk capacity (AT&T's WATS offerings) and resell it to our customers at very attractive retail prices higher than WATS, but lower than AT&T's DDD prices. Having been invited in by the FCC, this decision spawned a whole new industry of entrepreneurial companies - classic small businesses - who raised the capital necessary to purchase switching equipment from U.S. manufacturers (in our case DSC Communications in Richardson, Texas), and found sufficient working capital to run the business until it became profitable, thereby providing many jobs and filling the large pent-up demand for low cost telecommunications services.

There were as many as 500 of these small businesses whose owners had, in some cases, literally bet their life savings on this new telecommunications opportunity. While some of these companies concentrated on providing service in the major cities, many more chose to locate in smaller cities like Rochester, New York; Louisville, Kentucky; Little Rock, Arkansas; Raleigh and Greensboro, North Carolina; Napa, California; and Springfield, Illinois. It was those companies who introduced the benefits of low cost long distance service to most of the communities in our country.

This is a great example of small business helping small business. While large companies could economically construct WATS networks of their own (because of their large usage levels), resellers gave small businesses meaningful access to long distance savings for the first time, allowing them to be more competitive through control of their telecommunications cost - a major operating expense category.

As an example, my company's average commercial customer uses about $450 per month of our long distance service. Our customer base is drawn from all business segments: from trucking companies to market research firms to advertising agencies, law firms and travel agencies. Of course, we do have our share of major corporate customers as well, but the preponderance of our business base is smaller companies for whom lower cost telecommunications is often a distinct competitive advantage.

C. Background of A.C. Teleconnect

A.C. Teleconnect was formed in late 1981 as a Resale Common Carrier and began carrying traffic at its Rochester, New York switching center in May of 1982. The company expanded to the Binghamton region in 1984 and to both the Syracuse and Buffalo regions in early 1985. From its call origination areas covering all of Central and Western New York State, our company completes customer calls to the U.S. and portions of Canada.

In addition to the extremely rapid growth of our long distance services, the company began diversifying in 1984 through the acquisition of a telecommunications consulting firm, followed in 1985 by acquisitions of a small digital microwave-based OCC and a major Western New York land mobile radio and private communications systems house.

The company started fast, with 1983 revenues of $3.8 million. Since then, growth has continued to be very dramatic - to $9.8 million in 1984 and $23.3 million in 1985. Revenue growth continues at a fast pace in 1986.

Equally as important is the fact that the company is profitable - 1985 earnings were nearly $890,000. A.C. Teleconnect completed a most successful initial public offering of its common stock in late 1985. Let me emphasize that profitability is not the norm for today's long distance industry.

A.C. Teleconnect today is a full service telecommunications firm with branch offices in Buffalo, Syracuse, Binghamton, and Jamestown, New York. The company serves more than 17,000 commercial and residential customers, has assets in excess of $17 million and has added 135 new jobs to Central and Western New York State. It bears repeating that A.C. Teleconnect entered the market as a result of the FCC's "invitation" and that our growth and success came because AT&T was not allowed to crush us.

D. Impact of FCC Policies

As I mentioned previously, resellers like A.C. Teleconnect are not subject to the same degree of regulation as the so-called "dominant" carriers -- AT&T and the Bell Operating Companies (BOCs): rate regulation, rate of return, etc. That is because we are classed as nondominant carriers, i.e., we are unable to exercise market power because of size, control or position in the distribution channel. We have minimum market shares, offer no monopoly services and control no bottleneck facilities. With 85 percent market share, control of price and rate structures and with usage history to be able to target heavy users, AT&T is clearly a dominant carrier by any measure. Other industries entering deregulation have had nowhere near the level of total dominance which AT&T has over the long distance telecommunications market.

The FCC makes decisions, whether as a result of a tariff filing by AT&T, Bell Operating Companies, other exchange carriers or of its own volition, which can and do radically alter the nature of the competitive marketplace and change the rules under which the game is played. The FCC clearly can decide whether, over the long haul, this country's home and business long distance telephone users will get the competitive benefits of a "level playing field." Obviously such FCC changes can dramatically impact the profitability or viability of resale carriers whom we have observed to be small businesses. Yet I am unaware of any issue on which a specific analysis of the impact on small business has been conducted.

FCC Chairman Fowler's numerous public statements indicate that he (and presumably the other commissioners and FCC staff) fully expects the long distance market to become an oligopoly of large providers. Such statements of quasi-public policy have a discernable chilling effect on the ability of small businesses to raise the necessary capital to grow and prosper. Throughout our industry, some smaller resale companies are having great difficulties raising new capital or, worse, retaining the confidence of their present investors. In fact, if it were not for the aggressive diversification efforts of our company, our recent public offering would probably not have been so successful. Apart from the issue of capital, as such oligopoly predictions are repeated in the press, customers become reluctant to consider a smaller competitor because of the perception, however inaccurate, that "you might not be around next year."

In the face of such prevailing sentiment, why should the FCC bother to be concerned about the impact on these small businesses? In fact, this mentality can provoke a self-fulfilling-prophecy.

I personally, as well as on behalf of my colleaques both at A.C. Teleconnect and in our industry, vehemently assert that there is a continuing market opportunity for the small, well-managed regional carrier not only to survive, but also to continue to grow in the three critical dimensions of customers, sales and profitability. This opportunity for small business to flourish and provide new jobs for our economy cannot be allowed to stagnate or disappear because of (a) specific actions taken or (b) important opportunities to act that are ignored by the FCC.

E. Some Specific Examples

I understand that your Subcommittee is concerned with the FCC's failure to comply with the Regulatory Flexibility Act. That Act obligates the FCC (and indeed other government agencies) to meaningfully consider the impacts of its decisions and actions on the nation's small businesses. I do not believe that the Regulatory Flexibility Act was enacted simply to force government agencies to jump through one more bureaucratic hoop before making decisions. Rather, I believe that it was enacted to ensure that government bodies like the FCC carefully and fully consider the impact of their actions on the small business community in promulgating regulations.

While the letter of the Act may be limited to rulemaking proceedings and promulgation of regulations, I believe that the spirit of the Act is somewhat broader. It represents a sense of the Congress that opportunities for entry and growth by entrepreneurs and small business operators are central to our national economic well-being and that the government may not disregard the affects of its actions on such opportunities in its decision making. As illustrated by the following examples, the FCC, in its rush to deregulate and to yield its regulatory responsibility to marketplace forces, repeatedly has violated the letter and the spirit of the Regulatory Flexibility Act.

I don't think it's necessary for you to understand the details of the somewhat arcane tariffs and regulations under which our companies procure vital services (especially exchange access) from local exchange telephone companies (e.g. RBOC's) or from the carriers whose services we resell, (e.g. AT&T). But I do hope I can give you an appreciation for the speed and magnitude of the changes in regulations and tariff terms and conditions (sanctioned by the FCC) which make long term planning - not a strong suit in most small businesses -- at best a three month horizon.

I'll call the first topic "Access Charge Tinkering". So you have an idea of the magnitude of these charges for my company, in 1984 we paid $283,000 in access charges to the local telephone companies in our region. In 1985 these charges had grown to $2,061,000. This is clearly a big ticket item for our business, representing nearly ten percent of our gross revenues.

Access to local telephone exchanges -- necessary to originate and terminate long distance calls -- has been and remains a regulated monopoly service of local exchange telephone companies -- mainly the BOCs. Part 69 of the FCC's rules contains the complex regulations for establishment of access charges promulgated by the FCC. Local telephone companies file with the FCC tariffs containing rates and conditions for access service. Those tariffs are reviewed by the FCC for compliance with the Communications Act and with the access charge rules.

It has been only two years since the FCC's access charge rules became effective and since tariffs -- based on those rules -- were first implemented. Still during that brief period, the FCC has mandated changes to the rules and to the tariffs some of which have adversely impacted small businesses, including resale carriers.

On March 13, 1986, the FCC adopted a decision dramatically changing the access charge rules for access used in connection with WATS. As a result of this decision, access costs will rise significantly for resellers of WATS service. Prior to this decision, resellers of WATS did not pay access charges to BOCs for access lines used in connection with WATS. Instead, they paid the exchange carrier's normal business line rate (typically less than $50 per line). The reason was that WATS resellers indirectly paid access charges in their WATS rates charged by AT&T (which in turn paid access charges to the BOCs). Carriers which resell WATS in addition to providing service over some other type of facility received a "credit" enabling them to have some of their access lines repriced at the lower business line rates. The credit was determined by the proportion of WATS usage to total usage.

In its March 13 decision, the FCC eliminated these WATS "combined access credits" and for the first time mandated that WATS resellers pay access charges.

Although the FCC is allowing WATS resellers to pay only a portion of the access rate elements for existing lines until January 1987, as of that date WATS resellers will pay full access charges for all access services. This decision will dramatically increase WATS resellers' access costs and force them to modify their networks. The FCC never examined the effect of this decision on WATS resellers, most of which are small businesses. Less than a year ago, the FCC eliminated similar credits for the resale of WATS-type services provided by carriers other than AT&T.

Thus, in the past twelve months, the FCC has issued decisions which may increase A.C. Teleconnect's costs by a total of some $675,000 a year. If my company is typical of COMPTEL's other carrier members, some $64 million in transfer payments will be required from our industry.

My observations about "Access Charge Tinkering" are that access charges and conditions seem to be dictated by the RBOC's whims. Observation of the earnings posted by the RBOC's since divestiture would indicate that access charges greatly exceed access costs. From the standpoint of the impact on the

RBOC's, none of these changes are probably very important, yet the impact on small business as a customer is enormous. Nobody really thinks about the impact on us.

The next example I'll call the "WATS Taper Elimination". This one affected not only small business resellers, but also many small businesses. AT&T has a plan for very large business users called MEGACOM - which it offers to users who are big enough to bypass the RBOC's and deal directly with AT&T. WATS, obviously, is for the smaller user. WATS hourly rates used to decline with usage in a series of 4 steps or tapers. This structure has been around for years. AT&T applied for, and got, permission to eliminate the last rate step (the lowest price portion of the rate schedule).

a. Decision date = April 4, 1986
b. Effective date = May 1, 1986
c. Estimated impact = $216,000/yr
d. Action required to mitigate =
   reconfigure our network, yet again

My observations on the "WATS Taper Elimination" are that it squeezes the smaller user of WATS who may not have the volume of usage necessary to justify MEGACOM. The

FCC picked approval of this particular item out of a much larger rate restructuring by AT&T which in itself would have helped mitigate the effects. Thankfully my company's decision to reduce WATS usage had already been made, or the impact would have been much higher. Did the FCC consider the impact on small business?

These changes force resellers and other alternative carriers to modify their networks. For example, elimination of WATS access credits forces resellers to obtain transmission capacity other than WATS to resell. Such rearrangements take many months to plan, procure and implement. For a reseller, an optimized network is a requirement for profitability, yet as you can see, the rules change frequently and without much notice. There doesn't appear to be much consideration, if any, given to the impact of these changes on small businesses.

An analogy may clearly illustrate the frustration of the planning process in such an environment. Imagine that the Federal Election Campaign Act ground rules changed twice a year, and you had to react to and anticipate these changes in planning your campaign financing - recognizing very real penalties for taking the wrong action!

The next example I'll call "Failure to Act". The FCC continues to allow AT&T to recover gross revenue taxes from us, even though New York State Law specifically exempts us from these taxes. This costs my company $170,000 per year. While the issue seems pretty straightforward, in fact we've had to sue AT&T to recover monies already paid. Apart from the obvious legal costs, we've added three part-time staff people to handle the information requests from AT&T as part of their pre-trial discovery. Such burdens are proportionally greater on small business. As of today, AT&T continues to receive this amount as a windfall profit.

The last example I've called "The Inequality of Equal Access." Until so-called equal access truly exists, all long distance carriers are supposedly equal -- but, to borrow a phrase, one of them, AT&T, is more equal than others - much more.

When the Bell system was broken up, the U.S. District Court ordered that all competitors should receive a connection to the local telephone company's exchange network that would be equal in quality to AT&T's connection. Ironically, AT&T as owner of the BOCs was charged with developing the "equal access" plan. This plan was intended to produce a fully competitive telecommunications marketplace that could deliver the benefits of technological progress to the American consumer.

The BOCs were ordered to provide equal access to all interLATA carriers. The definition of equal access was limited to a customer perception comparison and no consideration was given to the many other technical and economic issues raised by the equal access issue. Primarily, no attempt was made to define or determine the value of equal access arrangements offered to the competitors during the transition period. Moreover, the court required that equal access be supplied pursuant to an expedited timetable. The schedule imposed was based primarily on the earliest time when the BOCs could complete the physical conversions, without consideration of its effect on competitive development.

The FCC has consistently assumed that such interconnections for AT&T's competitors will be truly equal to the arrangements enjoyed by AT&T. Experience shows, however, that the access which has been provided to our companies falls short of bringing us to interconnection parity with AT&T. This differential is due in part to numerous flaws in the equal access conversion process and in part to important longer term differences between the access services being provided to AT&T and the competitors.

Let me briefly describe three of the more serious problems with the equal access conversion process.

A. Equal Access conversion has been accomplished telephone office by telephone office. Since a city is generally comprised of many telephone offices, only parts of a city are converted to equal access at a given time. Consequently, there is confusion among consumers, and advertising the availability of "equal access' is costly and difficult, if not impossible, because different consumers in the same media market have different services available to them. Thus, selective and more targeted methods such as direct mail must be used, at a cost-per-prospect much higher than the costs for less selective and more effective wide-area media like television and radio.

Additionally, this scattered conversion process complicates the planning and implementing of any network additions by AT&T's competitors. And, administrative staffs are burdened with unnecessary complexities which AT&T, with its network connections already in place, need not face at all.

B. Payment of Feature Group D rates for calls terminating in non-"equal access" offices. AT&T enjoys the benefits of premium interconnections everywhere in the nation. However, because of the piecemeal introduction of equal access, we competitive long distance carriers and our subscribers cannot get the full benefit of so-called equal access. Many calls originating from converted central offices must terminate in offices with the old inferior interconnections -- those not yet converted. AT&T's competitors pay premium equal access rates on the originating end of that call. Obviously, to have our subscribers benefit fully from improved connections, those connections must be utilized at both the originating and terminating ends of the call. Since not all of the nation's central offices have converted to equal access, many calls from converted offices are going to central offices which are not yet updated. For these calls, the competitive long distance carriers are paying for equal access and not even receiving equal connections at both ends.

C. Confusing customer notification. As if the socalled "equal access" process is not confused enough, AT&T's competitors are finding that many customers who choose alternative long distance companies are being routed over AT&T AFTER customer cutover to equal access. Thus far, the FCC and the U.S. Department of Justice have found over 61,000 consumers misallocated to AT&T -- consumers who made an affirmative choice to use another long distance carrier.

The competitive long distance telephone industry has always emphasized self-reliance as well as innovation. What the industry seeks from the FCC and the Congress is no more than this: either genuinely equal access, or prices for unequal access that recognize the inequality for the access we receive. AT&T's competitors are not looking for a discount or a subsidy. What the competitive long distance carriers seek is simply fair groundrules for competition where we pay only for what we get. Until such policy is adopted, equal access remains an illusion.

F. Summary

I hope there are two important conclusions that you draw from my remarks. The first is that because we smaller carriers don't have a large (or indeed any) staff in Washington, it's impossible for us to participate - and make small business impacts known on the record - in every phase of every hearing on every docket before the FCC. I believe it is incumbent on the FCC to comply with the Regulatory Flexibility Act by considering and reporting the expected impact on small businesses in each of its decisions. Only in this way can it be held accountable for its actions. I would ask that you require this accountability from the FCC.

The second, and equally important conclusion follows from the first. If small businesses are precluded from being viable competitors to AT&T by the regulatory process, and if the FCC pursues its course of proceeding with the premature deregulation of AT&T, and if AT&T's other competitors can't survive a price war, this country may be left with an unregulated monopoly as the only provider of long distance service. At least that's one possible outcome.

Over the years, Congress has stood firmly for competition and against monopoly - whether it be oil, trucking or airlines. The question now is whether Congress will require the FCC to deregulate the long distance telephone industry in a way that builds competition, or in a way that perpetuates monopoly or oligopoly.

I don't believe Congress can, today, answer whether or not this country will have a freely competitive long distance market with opportunities for both small and large businesses or whether we'll have that unregulated monopoly. I believe the Congress should have an independent opinion of the likely outcome of the present course of the FCC and should continue to monitor that course to ensure that this country gets the competitive telecommunications marketplace which we all believe will maximize the benefits to the consumer and provide the opportunity for business to prosper.

Small Business and Communications Competition

Services and Equipment Only Big Business Could Afford Ten Years Ago

- Communications competition is bringing small businesses new telephone equipment and services which result in major cost savings, new business opportunities and improved management.
- Most were first offered or made affordable by competitive long distance companies or competitive equipment manufacturers moving into the small business market the Bell System had ignored. Competition then forced AT&T to follow with its own small business offerings.

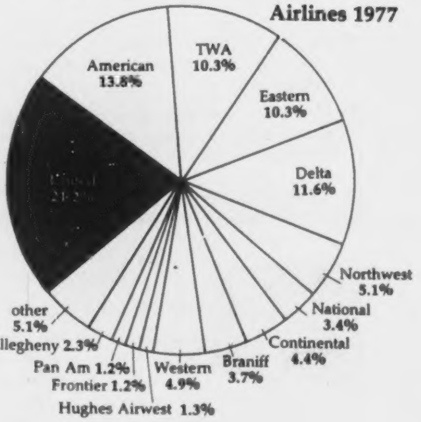
SERVICES & PRODUCTS	BENEFITS TO SMALL BUSINESS
AFFORDABLE LONG DISTANCE SERVICES	Competitive carriers offer savings of 5-25% off AT&T's long distance rates. Competitors' resale of AT&T services allow a small business to reap the savings of the bulk discounts AT&T offers only to big businesses. Shared 800 (incoming WATS) and other shared specialized business services are offered by long distance competitors at a price small businesses can afford, providing better customer service and stimulating new business.
ELECTRONIC OFFICE TELEPHONE SYSTEMS (PBX, SMART TELEPHONES)	Companies can now purchase their own phone systems, eliminating rental fees and saving thousands of dollars annually. Investment tax credits increase these savings. Managers are able to prevent unauthorized long distance calls from being charged to their business without their knowledge. Office systems automatically select the lowest cost long distance service for each outgoing call, saving hundreds or even thousands of dollars a year. Telephones can be moved as needs change without rewiring, saving expensive installation charges. Frequently dialed numbers can be called with the push of one button and conference calls involving three or more cities can be made without costly operator assistance.
AFFORDABLE DATA TRANSMISSION	Local retail companies can keep daily inventory records at their various stores through a central computer, and order from suppliers by computer. Independent insurance agents in the field can transmit claims and new policy information directly to the home office computers, thus avoiding delays and cutting expenses. Small retailers can instantly verify credit cards and checks. Local financial services brokers can access up-to-the-minute price and trading reports from a New York information base.
CALL ACCOUNTING SYSTEMS	Systems can automatically itemize calls by client, which assists in billing and cost allocation for a small law firm or other business. Detailed records of calling patterns are possible to allow for analysis and better cost control.

Market Power and Deregulation

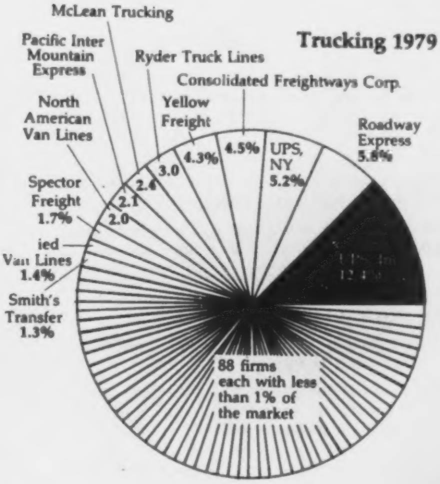
The structure of the trucking and airline industries just prior to their deregulation provides a revealing contrast to today's long distance telephone industry as the Federal Communications Commission continues to loosen restrictions on AT&T.

Tremendous competition existed in trucking and airlines the year before government regulation was lifted in each industry. Competition could protect consumers more effectively than any federal regulation and oversight.

Airlines 1977

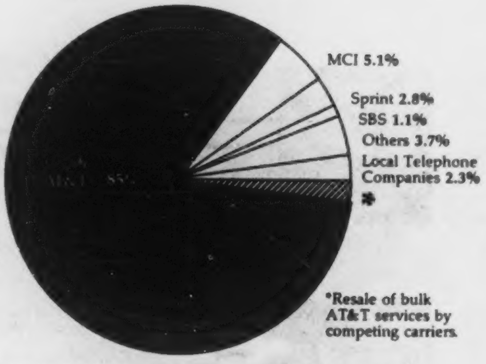


Trucking 1979



Each of these industries was structurally competitive, meaning that no one firm held market power over the entire industry. United was the largest airline with a 21% share of the market; in trucking, UPS was the largest carrier with a 12% market share.

Long Distance Service 1985



In the long distance telephone market, however, the dominant firm, AT&T, still maintains overwhelming control with at least an 85% market share.

*Resale of bulk AT&T services by competing carriers.

Sources: *Department of Transportation; Interstate Commerce Commission; National Telecommunications and Information Administration.*

Mr. **Skelton**. Mr. Mellon.

TESTIMONY OF RON MELLON, VICE PRESIDENT, TELEPHONE COMMUNICATIONS CORP., VAIL, CO, ACCOMPANIED BY VICTOR J. TOTH, COUNSEL

Mr. **Mellon**. Good morning, Mr. Chairman, members of the committee.

My name is Ron Mellon, and my counsel, Victor Toth is here to answer any questions you might have as well.

I am vice president of Telephone——

Mr. **Skelton**. May I interrupt.

Mr. **Mellon**. Certainly.

Mr. **Skelton**. I would like to state for the record that, unless there is objection, that the full statements of all witnesses today will be included in the record, and that we are of course asking you to summarize them within your 5-minute limitation.

Mr. **Mellon**. We have attempted to do that.

Mr. **Skelton**. Thank you.

Mr. **Mellon**. I am vice president of Telephone Communications Corp. [TCC]; we are a small telephone company, a reseller, based on the western slope of Colorado. We resell discounted long-distance telephone services. We compete with AT&T for long-distance business with small and medium-sized commercial and residential customers.

Starting from an investment of $250,000 3½ years ago, we have grown to roughly a $2 million operation. We have 8 employees, and we provide long-distance service to over 18 towns, all under 10,000 in population. They include Vail, Aspen, Dillon, Glenwood Springs—small towns on the western slope of Colorado.

We perform a valuable service which saves our customers about 20 percent on their long-distance bills.

I have been invited to share TCC's experience and frustrations as one party who recently complained to the FCC about its rulemaking process and its impact on small companies like my own.

My testimony addresses only one of several such experiences.

In February 1984, the Commission adopted a new set of rules—part 69. These rules resulted in the tariff for local exchange access charges to be paid by interexchange carriers engaged in either selling or reselling long-distance services.

The access rules included a very important exception directed specifically at firms like TCC, which limited their operation to reselling WATS and WATS-type services.

Section 69.5 of the rules exempted WATS and WATS-type resellers from having to pay the full charge for local exchange access.

Instead, the rules provided that WATS resellers could continue paying for access at local business line rates, a charge which was about 75–80 percent less costly than other forms of access under part 69.

TCC relied on this access treatment when it decided to enter the long-distance market. The opportunity to obtain access services through familiar channels of the telephone company's business office and at business line rates has been critical to the financial viability and efficient operation of our business.

On January 2, 1986, the FCC proposed eliminating section 69.5, the access charge exemption for WATS resellers. On June 1, 1986, WATS resellers, like TCC, were to begin paying the full complement of access charges, that is, business line rates would no longer apply, and even though the FCC had confirmed this access treatment just 7 months prior, the Commission provided only 3 weeks' notice to the resale industry to respond to its proposed rule change.

The FCC allowed only 5 months to make network changes to reduce the cost impact that the new rule would impose. The FCC's notice dismissed, in a mere footnote, any obligation whatsoever to comply with the requirements of the Regulatory Flexibility Act.

It thereby deprived WATS resellers of a full opportunity to expose the breadth and depth of the rule's impact on small business.

We replied to the Commission's proposal on its substantive merits, but our pleas were substantially disregarded.

In March 1986, the Commission concluded, without any evidence whatsoever, that WATS resellers were not covering the costs to the services that they were using. The Commission did modify its initial proposal. It phased in the new access charges over a 7-month period to lessen the impact of its new rule on WATS resellers.

Thus, the Commission, in effect, acknowledges that its action will have a major effect on small business resellers.

We argue that it is improper for the Commission to summarily dismiss the Regulatory Flexibility Act requirements. The U.S. Small Business Administration joined in support. Nevertheless, the FCC again, in a mere footnote, simply dismissed our arguments, and reiterated its duties under the Regulatory Flexibility Act extend only to those that are directly affected by its proposed rules and not to those who are affected only indirectly.

We believe that the FCC committed a legal error by failing to recognize the direct impact of its rule on WATS resellers.

In my opinion, had the Commission given the issue full impact analysis, which it deserves under the RFA, it would have come to a different conclusion. So, what impact does it have on my company? We are really not sure at this point.

As a result of this new rule, TCC's local access arrangement will soon be covered by the so-called access tariff.

I happen to have a copy of Mountain Bell's current access tariffs with me so that you can appreciate the challenge I face, a phenomenal challenge.

The current copy is approximately 897 pages. Since this tariff was filed 2 years ago, there have been over 130 revisions involving 2,000 additional pages.

Under the former rule 69.5, operating a WATS resale business has been very much like operating any other small business. Operating under the new rule as a full-blown carrier, subject to all the same ground rules as AT and MCI, will be very complex and costly.

In view of the impending change, TCC has tentatively concluded that it cannot operate any longer as a small business. It has entered into negotiations to merge with another large company.

Meanwhile, I will continue to focus my energy on applying these tariffs as best I can in hopes of minimizing the short-term financial impact.

Thank you for this opportunity to testify. I hope that I have offered something that will help you to craft improvements in the Regulatory Flexibility Act, and I would also like to commend the Small Business Administration for its efforts on behalf of small businesses like my own.

Mr. SKELTON. Thank you so much.

[Mr. Mellon's prepared statement follows:]

PREPARED STATEMENT OF RON MELLON, VICE PRESIDENT, TELEPHONE COMMUNICATIONS CORP., VAIL, CO

I am Ron Mellon, Vice President of Telephone Communications Corporation (TCC), a small business telephone company which operates on the Western Slope of Colorado. TCC is referred to as a discount long distance reseller. We compete with AT&T and the MCI's and GTE's of the world for the long distance business of small to medium-sized commercial and residential customers. Fortunately for TCC, AT&T and MCI do not compete as aggressively as we do for the small business and residential traffic of the rural communities. Consequently, starting from a modest capital investment of about $250,000 three and a half years ago, we have been able to grow to a $2 million operation. We have 8 employees, and provide long distance services to over 18 towns, all under 10,000 in population, including Vail, Aspen, Dillon, Avon, Redcliff, and others. In most instances we are the only long distance alternative that offers a genuine local presence. We believe we are doing a good job and perform a valuable service while saving our customers about 20% of their long distance bills.

Unfortunately, however, the more established we become, the more the Federal Communications Commission (FCC) sets out to undo our success.

This brings me to the purpose of my testimony. I have been invited to share TCC's experience and frustrations as one party who recently complained to the FCC about the callous insensitivity with which it regularly sets about to change its formal rules and policies without regard to their impact on small companies like mine. My testimony addresses only one of several such experiences.

By way of background, let me first explain the concept of long distance resale. It was originally perceived and promoted by the Commission itself more than a decade ago in Docket 20097. The FCC has concluded that it would be in the public interest to adopt rules and policies whereby small entrepreneurs could step up, unimpeded by regulation, freely and resell or "broker" the bulk discounted long distance services of large facilities-based carriers like AT&T, MCI and others. Its objectives were: to expose future discounted service offerings to competition through resale or brokerage, thereby minimizing the risk that they might be priced below cost; and to spread the benefits of discounted offerings to the maximum community of potential users. For the last five years these objectives have been met through a nationwide network of 400 to 500 small business resellers like TCC.

Apparently as a result of a change in philosophy, at the FCC, through its rulemaking process, appears to be committed to unraveling the resale industry just as quickly as it got started. Although I probably have not realized what has been going on in Washington for some time, the scenario has recently become familiar to me.

In the time frame between February, 1983 and February, 1984, after much fine tuning, the Commission adopted a new set of Rules -- Part 69. These rules established a tariffed system of local exchange access charges to be paid by all interexchange carriers engaged in either selling or reselling long distance services or facilities. But this system of access charges, as initially devised, included a very important exception directed specifically at firms like TCC and the several hundred others like it that limited their operations to reselling WATS and WATS-type services exclusively. Section 69.5 of the rules exempted WATS and WATS-type resellers from the onerous burden of having to pay the full charges for local exchange access.*/ Instead, the rules simply provided that so-called WATS resellers could continue paying for access at local prevailing business line rates -- a charge which typically amounted to 15% of other forms of access under Part 69.*/

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*/ Local exchange access, is a term which refers to the combination of local telephone lines and central office equipment which enables a subscriber to pick up his/her telephone, obtain a dial tone and, upon dialing a "1" and seven or ten digits, be connected to and routed through the facilities of one or other long distance carrier.

In reliance on this access treatment TCC persisted with its business plans to pursue the long distance market. In order to retain the access exemption, TCC was careful to limit the services that it resold to only those which qualified for business line treatment. Considering that there is not much else available to resell other than WATS in the remote markets that we serve, the opportunity to obtain access services through a rather simple process and at business line rates has been critical to the financial viability and efficient operation of TCC's business.

The WATS reseller exemption provided for in the Part 69 rules appeared to be firmly incorporated in the first set of local exchange carrier (LEC) access tariffs that took effect almost two years ago to the day -- May 25, 1984. In fact, on one occasion since the tariff first went into effect the local exchange carriers attempted to obtain a waiver of the Rule so that they could charge WATS resellers full access rates.

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*/ This is not to suggest that WATS resellers were receiving favored treatment. The reason for not assessing the full Part 69 access charges to WATS resellers had to do with the kind of services we were reselling, i.e., primarily WATS and the fact that the local carriers already collected Part 69 access charges for the resellers use of WATS service from AT&T. Thus, the exemption was simply intended to avoid a double recovery or "windfall" for the local exchange companies. (See, e.g., cc Docket No. 83-1145, Phase I, Memorandum Opinion and Order, released February 17, 1984 (FCC 84-51), at A.3-2.

The Commission's Common Carrier Bureau flatly turned them down and stated that the LECs had not shown any cost justification for a change in the lenient access treatment of WATS resellers.*/

As a person trying to run a small business 1,500 miles from Washington, D.C., one would think that it would be reasonable to rely on such unequivocal action as evidence that the ground rules upon which my business had been based for nearly four years were firmly in tact..

Well, it was not to be. First, in October 1, 1986, without notice or any action by the Commission whatsoever, the Common Carrier Bureau allowed the LECs unilaterally to change their access tariffs and reduce the scope of the rrule 69.5 exemption to exclude the category of so-called WATS-Type resold services. This apparently was done under the guise of a new "interpretation" of Rule 69.5 -- notwithstanding the fact that for over a year and a half the rule had been interpreted and applied by the FCC and virtually the entire LEC and reseller industries to include such services within the exemption.

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*/ See, e.g., Petitions for Waiver concerning 1985 Annual Access Tariff Filing Memorandum Opinion and Order, Mimeo No. 5007, released June 7, 1985, at para. 8.

The coupe de grace came three months later on January 2, 1986. The FCC issued a Notice of Proposed Rulemaking in which, at its own initiative and on a fast track basis, it proposed eliminating the Section 69.5 access charge exemption for WATS resellers.*/ The FCC proposed that on June 1, 1986, WATS resellers like TCC should begin paying the full compliment of access charges -- i.e., business line rates would no longer apply, notwithstanding its ruling dening a waiver for the same change just seven months earlier. It was disheartening enough that the Commission provided only three weeks notice for the resale industry to respond to its proposed rule change. (Our counsel's request for an extension of time was summarily denied.) It was equally aggravating that the FCC actually believed that it was being generous in allowing a full five months for WATS resellers to make the necessary major reconfigurations in their networks to scale back and avoid the cost impact that the rule change would impose.**/

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*/ WATS Related and Other Amendments of Part 69 or the Commission's Rules, CC Docket No. 86-1 (FCC 86-1) released January 6, 1986.

**/ The Commission stated: "In allowing WATS resellers to pay the local business line rate, we expressed concerns about the adverse rate impact on resellers if they were required to pay full carrier charges at the outset of the access charge regime. . . . However, we no longer think that such concerns provide an adequate basis for retaining the ENFIA system of allowing WATS resellers to obtain interstate access services for payment of local business line rates . . . Resellers will have more than six [sic] months from the issuance of this Notice to make whatever adjustments they deem appropriate in their planning and network configurations in light of the changes proposed herein." Id, p. 9 n. 27.

In other words, what was announced procedurally as a "proposal" was, in fact, au fait accompli. But, to add insult to injury, the FCC's Notice dismissed in a mere footnote,*/ any obligation whatsoever to comply with the requirements of the "Regulatory Flexibility Act" to the extent it might have served to highlight the breath and depth of the impact on small business WATS resellers due to this rule proposal. We tried to reply to the Commission's proposal on its substantive merits but, as we expected, our pleas were substantially disregarded. In March, 1986, the Commission concluded **/ without any new evidence whatsoever, that WATS resellers were not covering the costs of the services they were using even though, just seven months earlier, the Commission had stressed that WATS resellers were pulling their weight, so to speak, in terms of covering their costs at business line rates.

As a consolation for our efforts the Commission did modify its

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*/ Footnote 54 simply states:
"We have previously determined that the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601-12 (1982), are not applicable to proceedings in this docket in that local exchange carriers, the parties directly subject to our rules, do not fall within the Act's definition of a 'small entity'. Id. Sec. 601. See Access Charge Order at paras. 358-62." Id., p. 21, n. 54.

**/ Report and Order, CC Docket 86-1, released March 21, 1986 (FCC 86-115).

initial proposal to phase in the new access charges over an extended seven month time period in order, thereby to ameliorate the impact of its new rule on WATS resellers.*/

Our counsel also argued during the proceeding that it was improper for the Commission to summarily dismiss the applicability of the Regulatory Flexibility Act (RFA) requirements in the course of considering new rules specifically targeted at small business WATS resellers. I understand that several parties joined in support, including the U.S. Small Business Administration but, as we have come to expect, and with the same indifferent attitude that it had manifested in its original Notice, the FCC -- again in a mere footnote -- simply dismissed our arguments by reiterating that its duties under the Regulatory Flexibility Act extend only to those that are directly affected by its proposed rules and not to those who are only indirectly affected.**/

In the Commission's view Part 69 merely directs the LECs to reflect theCommission's access policies in their respective access tariffs. The tariffs, then, govern the LEC's relationships with the interexchange carriers, including resellers. Since the WATS resellers do not file access tariffs but are only governed by them, they are not directly affected by the Part 69 rules and therefore, according to the FCC an analysis of the rule's impact on small businesses is not required!

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*/ The Commission stated: "While we are determined that the rule changes providing for special access treatment of WATS access lines go into effect on June 1, 1986, we are not unsympathetic to the transitional problems faced by resellers in trying to respond to these changes and reconfigure their networks. A 'flash-cut' approach here could potentially have a serious negative impact on some resellers, particularly because of possible time delays in the processing of orders for alternative facilities and uncertainty regarding the extent to which AT&T's WATS rates will change as a result of our Order." Id. p. 23, para. 27.

**/ Id. p. 22, n. 96.

It is ironic, of course, that the Commission should conclude on the one hand, that its proposed new rule does not have a direct affect on WATS resellers for RFA purposes and, on the other hand, conclude that the impact is at least direct enough to warrant a brief portponement of the rule (al beit inadequate). In my opinion, had the Commission given the issue the full impact analysis which it deserves under the RFA and allowed its decision to be governed accordingly, it very well might have come to quite a different conclusion -- one which would have maintained the status quo for WATS resellers.

Where does this leave TCC? I wish I knew for sure. Part of the reason for my uncertainty is that as a result of this new rule TCC's local access arrangements will soon be covered by the so-called access tariffs. I happen to have a copy of Mountain Bell's current access tariff here with me so that you can appreciate what I am up against. The current copy is approximately 897 pages and weighs about 8 pounds. Since this tariff was first filed two years ago there have been over 130 revisions amounting approximately to another 2000 tariff pages or 18 pounds of paper. Mountain Bell's tariff changes required to implement the new Part 69 rule discussed throughout this testimony amounted to over several hundred pages alone. If I were to attempt to maintain a current copy of only Mountain Bell's interstate access tariff (it also has an intrastate tariff just like it), it would cost me at least $900/year just for the paper. In addition, once I make adjustments in my network to compensate for the new rule changes I guess I will be expected to purchase and maintain a copy of the similar access tariffs of every other major operating company in the country, or at least one for each of the BOCs, Eagle Telephone Company, the GTOCs, NECA, and the two or three other large independents with whom we will be doing business. As this SubCommittee might appreciate -- but the FCC, obviously, does not -- the effect of the Part 69 rule change goes beyond merely increasing my cost of access services dramatically. The rule now throws me into a whole new business, or at least a new way of doing business -- one which I was not planning for and one for which TCC is not staffed to become involved in.

Life as a WATS reseller was relatively pure and simple. Life as a full blown carrier subject to all the same ground rules as AT&T and MCI could very well prove to be out of our league -- not just simply unaffordable and incomprehensible to small firms like TCC, but also beyond the practical reach of the small communities that WATS resellers, and only WATS resellers, typically serve.

In view of the impending change, TCC has tentatively concluded that it cannot operate any longer as a small business. It has therefore entered into negotiations to merge with another, larger company. Meanwhile, I will continue to focus my energies on applying these tariffs as best as I can to our particular situation in hopes of minimizing the short term financial impact -- hopefully, limiting our exposureto no more then an additional fifteen or twenty housand dollars per month for access. So far, however, this has not been a successful process. Even with the help of Mountain Bell's tariff staff, the rules of the game in the access tariff environment continue to change at least monthly, if not more often. No sooner do we think that we see a plan for conversion, then Mountain Bell files another new tariff wrinkle into the access scheme. Clearly, the FCC has never attempted to play by the rules which it so cavalierly sets down for others to follow.

Thank you for this opportunity to testify, and I hope that I have offered something that will help you craft improvements to the Regulatory Flexibility Act.

Mr. SKELTON. Mr. Coble.

Mr. COBLE. No questions.

Mr. SKELTON. Mr. Dundon, what would the long-term effect be on your business and other small business of the FCC's recent changes in the access charge tariffs and rules, in your opinion?

Mr. DUNDON. There are both short-term and long-term effects, Mr. Chairman. The short-term effects are those that I expressed earlier. Longer term, we have the opportunity to reconfigure our terminating network. It probably bears stating that there are basically three areas of cost, general administrative expenses which we face, which are our own to control; the access costs, which we really have no control over, since they are mandated by the telephone company's tariffs; and, the third, are the networks that we purchase for resale to be able to terminate our traffic, and there is the area where we do have control.

If the FCC's policies continue, there will remain a chilling effect on the ability of companies, whether they be small businesses like mine, or alternative carriers, to develop the necessary financing to put in place the networks nationwide, which can compete effectively with AT&T. The inescapable conclusion will be that we will go back to AT&T as an unregulated monopoly, being the only viable provider of network services in this country. I think that is a mistake.

Mr. SKELTON. You have both indicated—you say, some substantial problems that are being ignored by the FCC. Do you have a recommendation, each of you, for us?

Mr. MELLON. My question to my counsel was, was well, why don't we just—if they have ignored the law, why don't we just take them to court and solve the problem?

And his answer to me is there is——

Mr. SKELTON. No judicial review.

Mr. MELLON [continuing]. There's no judicial review, and, if there was, he would do that on my behalf and on behalf of others like my company that he represents.

Mr. SKELTON. In other words, your recommendation would be to take out that word "not"?

Mr. MELLON. Clearly.

Mr. SKELTON. And require judicial review, or allow it.

How about you?

Mr. DUNDON. I would agree with that conclusion also, Mr. Chairman, but I also think that the oversight hearings which this committee is having go a long way to requiring the appropriate treatment by the FCC of its obligations under the Regulatory Flexibility Act.

Mr. SKELTON. Thank you both, very much. I appreciate your traveling to be with us.

The Chairman of the FCC, Hon. Mark S. Fowler—is he in the room, please?

He will be.

Counsel.

Mr. LYNCH. Mr. Chairman, one of the witnesses said that a study had been done on the regulatory costs of the various tariff filings and everything, if they could submit a copy of that for the record.

Thank you very much.

[The study referred to by Mr. Lein follows:]

Reducing Regulatory Costs and Maintaining Needed Revenues

Goals

- o Reduce reporting and filing requirements, administrative burdens and costs, and regulation for small telephone companies at the Federal level.
- o Have implemented revenue plans that 1.) provide reasonable revenues for small high cost companies, 2.) discourages bypass for all companies, 3.) maintain average schedules and 4.) results in reasonable rates for small company customers.

Increased Federal Regulation Results in Increased Costs for Small Telephone Companies

The following chart was informally gathered from the members of the United States Telephone Association Small Company Committee:

Per Access Line Per ~~Year~~ MONTH

Administrative Cost	High	Low
Local Rate Cases	$ 16.86	0.00
FCC Tariff Filings	19.60	2.39
Estimated Cost of Implementing the new USOA	Avg. 4.14	
Costs associated with divestiture	54.88	1.57
Separations Cost Studies	23.52	0.00
Total Per Year per Access Lines	44.60	6.71
Total Per Month per Access Lines	3.72	.56

Excessive Federal regulatory requirements designed for large companies and imposed on small companies significantly increase costs, decrease flexibility, and slow the introduction of new services in rural areas. This is not in the public interest and the customer pays for it. An overall regulatory framework is needed to promote the best interest of rural and small town customers who happen to live in high cost areas.

Issues and Solutions

1. Computer III proposes to increase regulation by expanding the dominant carrier label thus increasing regulation and requiring small companies to keep more complex accounting records.

   Classify small telephone companies as non-dominant.

2. USOA as proposed increases accounting requirements and costs.

   Have simplified requirements for small telephone companies and provide option of maintaining current system.

3. Rate of Return requires rate of return by rate element rather than overall.

   Give small telephone companies a choice of Industry average or individual company return. Eliminate by element requirement.

4. Carrier Common Lines (CCL) has created complex reporting requirements to NECA.

   Permit NECA to file an average access charge tariff and small companies could concur on a bill and keep basis.

5. From small company viewpoint traffic sensitive tariffs are lengthy, complicated and require massive cost support.

   New dominant classification would permit small telephone companies to file simplified tariffs with minimum or no cost support.

6. Average Schedules are essential to many small telephone companies.

   Maintain average schedules.

7. The High Cost Fund is necessary for universal service.

   Maintain HCF for NTS costs. A smaller HCF should be developed for local transport and traffic sensitive for universal service purposes and in the event of toll rate deaveraging.

USTA Small Company Committee

Reducing Regulatory Costs and Maintaining Needed Revenues

I. Goals

1. Reduce reporting and filing requirements, administrative burdens and costs, and regulation for small telephone companies at the Federal level.

2. Have implemented plans that 1.) maintain universal service for customers of small high cost companies, 2.) discourages bypass for all companies, 3.) maintain average schedules and 4.) results in reasonable rates for small company customers.

II. Increased Regulation Results in Increased Costs for Small Telephone Companies

The following chart was informally gathered from the members of the United States Telephone Association Small Company Committee:

Per Access Line Per ~~Year~~ MONTH

Administrative Cost	High	Low
1. Local Rate Cases	1.41	0.00
2. FCC Tariff Filings	1.63	.20
3. Separations Cost Studies	1.96	0.00
4. Total Per Month per Access Lines	5.00	.20

III. The FCC Should Adopt Rules Which Require Consideration for Reduced Regulation in all FCC Dockets for Small Telephone Companies

1. Federal regulatory requirements designed for large companies and imposed on small companies significantly increase costs. Small companies have less customers to support the burdens of FCC regulation and the requirements resulting from FCC decisions. An overall regulatory framework is needed to reduce costs and requirements for small telephone companies. An excellent example is the State of Iowa where small telephone companies are not rate regulated.

2. To maintain Universal Service, it is necessary to consider the cumulative effect of all the issues and decisions on small companies and their customers.

IV. Specific Small Companies Issues

1. Computer III proposes to increase regulation by expanding the dominant carrier label thus increasing regulation and requiring small companies to keep more complex accounting records.

2. USOA, as proposed, increases accounting requirements and costs.

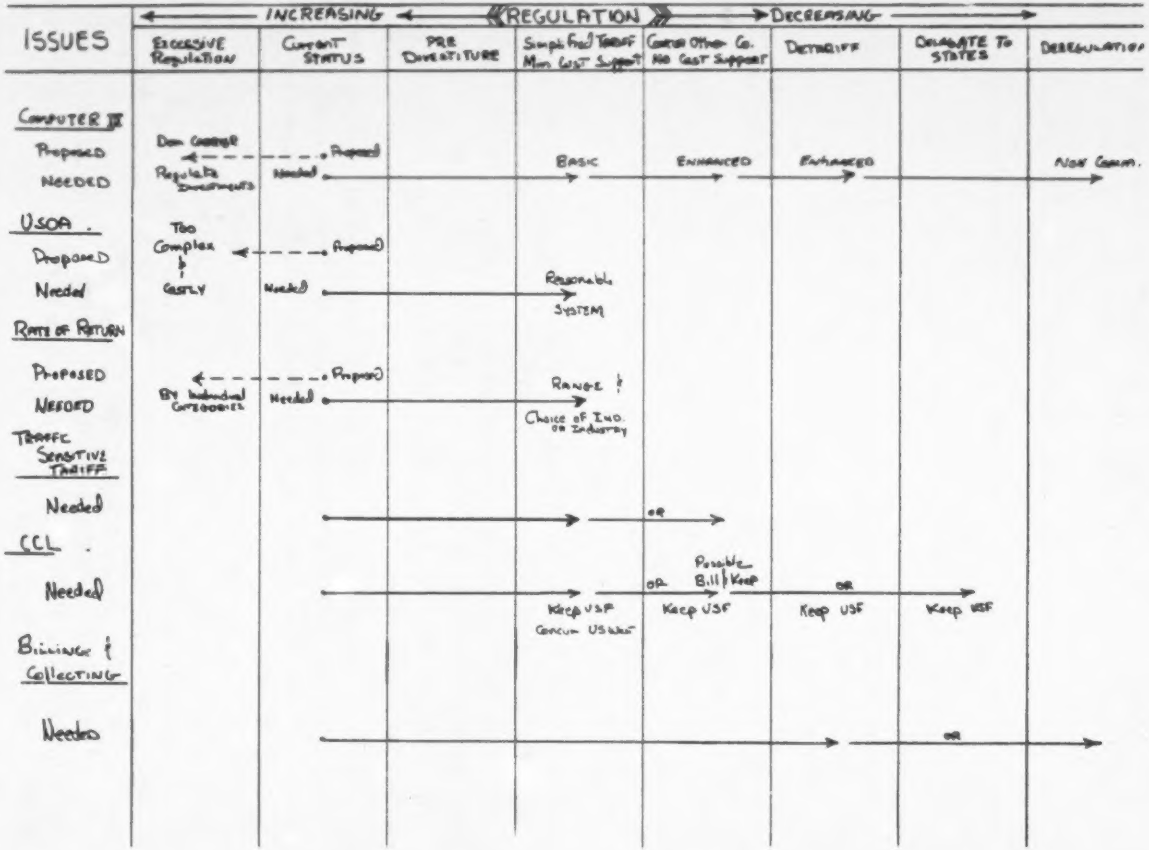
3. Rate of Return requires rate of return by rate element instead of overall, thus, increasing costs.

4. From small company viewpoint traffic sensitive tariffs are lengthy, complicated and require massive costs support.

5. Average Schedules are essential to small telephone companies.

6. Changes in the allocation of Category 6 Central Office Equipment has the potential to raise local rates significantly for small telephone companies.

REDUCING REGULATORY REQUIREMENTS FOR SMALL COS.



INCREASING
REGULATION
DECREASING
ISSUES
Excessive Regulation
Current STATUS
PRE DIVESTITURE
Simplified Tariff Min Cost Support
Concur Other Co. No Cost Support
Detariff
Delegate To STATES
Deregulation
COMPUTER III
Proposed
NEEDED
Dom Carrier
Regulate Investments
Proposed
Needed
BASIC
ENHANCED
Enhanced
Non Comm.
USOA.
Proposed
Needed
Too Complex & Costly
Proposed
Needed
Reasonable SYSTEM
RATE OF RETURN
PROPOSED
NEEDED
By Individual Categories
Proposed
Needed
RANGE &
Choice of Ind. or Industry
TRAFFIC SENSITIVE TARIFF
Needed
OR
CCL.
Needed
Keep USF
Concur USWest
OR
Keep USF
Possible Bill & Keep
OR
Keep USF
Keep USF
Billing & Collecting
Needed
OR

Mr. Skelton. Mr. Chairman, we have been waiting for your appearance with bated breath. Were your ears burning all the way over here? [Laughter.]

Our colleague, Mr. Ireland, had to step out. He will return. However, we would like to ask you at this time to make your presentation. You might be fully aware of the fact that there are a number of witnesses who have preceded you with some very serious comments about the Federal Communications Commission, and some recommendations following therefrom.

So, we will ask you to testify; then, we will have questions for you thereafter.

Thank you.

Mr. Fowler. Thank you, sir.

I will try to keep the oral presentation short, too; and I have a written statement that is longer that I will submit.

Mr. Skelton. Yes, sir; it is understood that any written statements will be included in full, and if you would summarize, we would appreciate it.

Mr. Fowler. Thank you, sir.

TESTIMONY OF HON. MARK S. FOWLER, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION, ACCOMPANIED BY JACK SMITH, FCC GENERAL COUNSEL, ALBERT HALPRIN, CHIEF, COMMON CARRIER BUREAU, JAMES McKINNEY, CHIEF, MASS MEDIA BUREAU, AND ROBERT FOOSANER, CHIEF, PRIVATE RADIO BUREAU

Mr. Fowler. Chairman Skelton, members of the subcommittee.

I appreciate the opportunity to appear before you today and discuss how the FCC has sought to implement the Regulatory Flexibility Act of 1980.

With me today, on my right, are Jack Smith, our general counsel, and, on my left, is Albert Halprin, Chief of the Common Carrier Bureau, James McKinney, Chief of the Mass Media Bureau, and Robert Foosaner, Chief of the Private Radio Bureau. Mr. Foosaner is here, and Mr. McKinney is here.

I will begin my remarks today by giving a brief overview of the Regulatory Flexibility Act and the procedures we have relied on during the past 5 years.

That act was promulgated to make Government agencies more aware of the burdens that Government agencies impose upon businesses, particularly small entities.

To achieve this goal, we established in 1981, a regulatory review working group, which served to consolidate our obligations under paperwork reduction, regulatory flexibility, and our own management by objective system for rule and policy review.

At that time, we set upon an ambitious plan to review every rule and policy of our agency within 3 years. At the completion of each stage of review, a notice was issued requesting public comment on the economic impact those rules were having on small entities.

When comments concerning the impact of a particular rule were received, the appropriate operating bureau would make recommendations whether and to what extent a modification was needed.

We are enormously pleased to report that we have virtually completed this comprehensive review of our rules 5 years ahead of the statutory deadline.

As a result of these and other rule review proceedings, we have made significant strides in eliminating unnecessary and burdensome regulations.

To ensure that new rulemakings do not impose unnecessary paperwork burdens on small businesses, the FCC has established procedures for all Commission bureaus and offices to follow in the preparation of all rulemaking items. These procedures require our employees to prepare an initial and, when necessary, a final regulatory flexibility analysis for each rulemaking, unless we certify pursuant to section 605(b) of the act that our contemplated action will have no significant economic impact on small entities.

These analyses or certifications are then reviewed by the various bureaus or offices of the Commission, as well as by the Office of General Counsel.

In addition, to give small entities notice of our contemplated actions, we submit our semiannual regulatory flexibility agenda to OMB for publication in the Federal Register as part of the unified agenda. And we submit copies of rulemaking notices to publications of interest to small businesses.

In our experience, few entities have commented on our regulatory flexibility agenda or the regulatory flexibility analyses contained in our rulemaking notices. Instead, information about the impact of our rulemaking proposals is generally contained in comments directed to the substance of particular rulemaking proposals.

In assessing the impact on small entities, the Commission looks to these comments and also relies on its staff's experience and special knowledge of the regulated industry, as well as any data already in the Commission's files.

Although our regulatory flexibility analyses do not, themselves, lead to much comment, we are acutely aware of the needs of small entities. During the last 5 years we have taken numerous actions that should significantly benefit small entities.

For example, in the mass media service, since 1981, the FCC has eliminated many of its paperwork burdens on regulated industries. Renewal for many broadcast stations is now the size of a postcard.

The Commission has also eliminated unnecessary reporting requirements; financial showings by our licensees have been eased or eliminated in many services.

Generally, the Commission requires financial showings only where it is necessary to ensure that valuable spectrum is not tied up for years by an applicant who lacks the financial resources to utilize it.

During the same time period, the Commission has also made possible new avenues of business opportunity for small entities.

Our actions concerning the private radio services are also worthy of note because many small businesses use these services. The private land mobile radio service has received 600 new channels over the last 5 years. Another 40 channels have been made available for private carrier paging services.

We have also modified or eliminated numerous restrictive rules. For example, in the maritime radio services, we very recently reduced the number of rules these licensees must comply with by 40 percent. This revision should not only eliminate 2,880 burden hours of recordkeeping requirements, but it will make the rules much easier to use.

Finally, we have improved our licensing procedures so that faster service is provided to the public. For example, in 1984, our processing staff in Gettysburg processed 352,303 land mobile authorization requests, or 24 percent more than in 1981, while reducing the overall processing time for land mobile radio from approximately 60 to less than 30 days.

The Commission has also taken numerous steps to assist small telephone companies and their subscribers. These measures include a lifeline assistance program, which is available to subscribers in urban and rural areas; and more than $400 million earmarked for assistance to telephone companies serving high-cost areas, typically small rural telephone companies.

Under our high-cost assistance formula, a small company receives substantially more assistance than a larger company with the same costs.

Our formula also treats all companies as if they have the same cost of capital, even though many small companies have very low capital costs due to well below market rate Rural Electrification Administration loans.

Imputing this cost of capital provides hundreds of REA borrowers with an additional financial cushion. Informal estimates made by the FCC staff at the time of that decision indicated that this measure alone increased the assistance to small telephone companies by roughly $20 million.

The Commission has also provided for mandatory pooling of local loop costs to facilitate the averaging of interstate toll rates. The data currently available to us shows that our efforts to ensure the preservation of universal service in rural areas has been successful.

Telephone subscribership outside metropolitan areas has remained stable and REA reports that its small telephone company borrowers have improved their financial performance substantially in recent years.

We have also taken steps to ease the administrative burdens on small telephone companies.

We have maintained the system of average schedule compensation for small telephone companies. This allows them to be paid for interstate toll use of their facilities without having to perform cost studies like other carriers.

We recently approved revisions to this formula, which the National Exchange Carrier Association estimates will increase the payments to approximately 600 of the 730 or so companies which use this formula.

The new telephone company accounting system recently adopted by the Commission is another example of our efforts to reduce regulatory burdens on small telephone companies. It establishes simplified accounting rules for companies with less than $100 million in annual revenues. Previously, only telephone companies with less than $250,000 in annual revenues were allowed to use simplified procedures.

We have also eliminated or reduced reporting requirements for small companies in a number of other proceedings. One good example is our recent decision to eliminate the annual Form M filing requirement for telephone companies with less than $100 million in annual revenues. Previously, all companies with revenues in excess of $1 million were required to file. Another example is our elimination of the many financial reports required from radio common carriers.

In conclusion, we believe that the goals of the Regulatory Flexibility Act, in many ways parallel the public interest goals of the Communications Act, for both are concerned with the quality of service to the public.

We take our public interest responsibilities very seriously, and we are constantly striving to enhance the benefits to small entities.

The Commission will continue to respond to their needs by encouraging the entry of small businesses into the marketplace and removing unreasonable restrictions and paperwork burdens from existing services.

Actually, Chairman Skelton, I would like to indicate to you and members of the subcommittee that I think we have been overall, and the record will show, a leader in reducing both regulation and paperwork. In terms of all of the Federal agencies in paperwork reduction, I think we are in the top five for the entire Federal Government, and we are a relatively small agency, but we do take our responsibilities seriously.

We are not perfect, though, and I look forward to your questions.

Mr. SKELTON. Thank you so much.

[Mr. Fowler's prepared statement follows:]

PREPARED STATEMENT OF HON. MARK S. FOWLER, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

CHAIRMAN SKELTON AND MEMBERS OF THE SUBCOMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY AND DISCUSS HOW THE FEDERAL COMMUNICATIONS COMMISSION HAS SOUGHT TO IMPLEMENT THE REGULATORY FLEXIBILITY ACT OF 1980 (ACT), 5 U.S.C. § 601, ET SEQ. WITH ME TODAY ARE JACK SMITH, THE COMMISSION'S GENERAL COUNSEL, ALBERT HALPRIN, CHIEF OF THE COMMON CARRIER BUREAU, JAMES MCKINNEY, CHIEF OF THE MASS MEDIA BUREAU AND ROBERT FOOSANER, CHIEF OF THE PRIVATE RADIO BUREAU. WE WILL ALL BE AVAILABLE TO ANSWER ANY QUESTIONS AT THE CONCLUSION OF MY STATEMENT.

I WILL BEGIN MY REMARKS TODAY WITH A BRIEF OVERVIEW OF THE REGULATORY FLEXIBILITY ACT AND THE PROCEDURES THAT WE HAVE RELIED ON DURING THE PAST FIVE YEARS TO EFFECTUATE THE ACT. I WILL THEN DESCRIBE SOME OF THE COMMISSION'S EFFORTS TO ASSIST SMALL BUSINESSES WHICH GO BEYOND THE REQUIREMENTS OF THE ACT. AN OVERVIEW OF THESE INITIATIVES WILL, I HOPE, HELP THE COMMITTEE UNDERSTAND THE EXTENT TO WHICH WE HAVE SOUGHT TO BENEFIT SMALL ENTITIES BY MAKING NEW COMMUNICATIONS SERVICES AVAILABLE AND MAINTAINING THE BEST COMMUNICATIONS SYSTEMS IN THE WORLD AT THE MOST REASONABLE PRICES.

THE REGULATORY FLEXIBILITY ACT WAS PROMULGATED TO MAKE GOVERNMENT AGENCIES MORE AWARE OF THE BURDENS THEY IMPOSE UPON SMALL ENTITIES. THE LEGISLATIVE HISTORY INDICATES CONGRESSIONAL CONCERN THAT GOVERNMENT REGULATIONS AND PAPERWORK REQUIREMENTS OFTEN IMPOSED SIGNIFICANTLY GREATER BURDENS UPON SMALL ENTITIES. BECAUSE OF THEIR SIZE AND LIMITED RESOURCES, CONGRESS

FEARED THAT PAPERWORK BURDENS COULD HINDER THE ABILITY OF SMALL BUSINESSES TO COMPETE WITH THE LARGE COMPANIES. CONGRESS HOPED THAT REQUIRING AGENCIES TO REVIEW THEIR RULES, BOTH THOSE CURRENTLY IN EFFECT AND THOSE SUBSEQUENTLY PROMULGATED, WOULD MAKE AGENCIES MORE AWARE OF THE BURDENS THEY ARE IMPOSING UPON SMALL ENTITIES.

TO ACHIEVE THIS GOAL, THE ACT REQUIRED AGENCIES TO DEVELOP A PLAN FOR REVIEWING WITHIN TEN YEARS ALL RULES IN EXISTENCE AT THE TIME THE ACT BECAME EFFECTIVE. IN ADDITION, ALL RULES ADOPTED AFTER THE EFFECTIVE DATE OF THE ACT MUST BE REVIEWED WITHIN TEN YEARS OF THEIR PUBLICATION. THE PURPOSE OF THE REVIEW IS TO DETERMINE WHETHER THOSE RULES WHICH HAVE OR WILL HAVE A SIGNIFICANT ECONOMIC IMPACT UPON A SUBSTANTIAL NUMBER OF SMALL ENTITIES SHOULD BE MODIFIED OR RESCINDED.

THE ACT ALSO REQUIRES AGENCIES TO PREPARE AN INITIAL REGULATORY FLEXIBILITY ANALYSIS FOR NOTICES OF PROPOSED RULEMAKING AND A FINAL REGULATORY FLEXIBILITY ACT ANALYSIS FOR THE FINAL ORDER. ALTERNATIVELY, THE ACT EMPOWERS AGENCY HEADS TO CERTIFY THAT CERTAIN RULES WILL NOT "HAVE A SIGNIFICANT ECONOMIC IMPACT ON A SUBSTANTIAL NUMBER OF SMALL ENTITIES."

IN ADDITION, THE ACT REQUIRES AGENCIES TO PUBLISH A SEMI-ANNUAL REGULATORY FLEXIBILITY AGENDA CONTAINING INFORMATION THAT MAY ASSIST SMALL ENTITIES IN INDENTIFYING RULES THAT COULD AFFECT THEM. AGENCIES ARE ALSO ASKED TO MAKE EVERY EFFORT TO

NOTIFY SMALL ENTITIES OR THEIR REPRESENTATIVES OF THESE REGULATORY FLEXIBILITY AGENDAS THROUGH DIRECT NOTIFICATION OR PUBLICATION IN PERIODICALS LIKELY TO REACH SMALL ENTITIES IN ORDER TO ENCOURAGE THEM TO FILE COMMENTS ON THESE AGENDAS.

IN 1981, WE ESTABLISHED A REGULATORY REVIEW WORKING GROUP WHICH SERVED TO CONSOLIDATE OUR OBLIGATIONS UNDER PAPERWORK REDUCTION, REGULATORY FLEXIBILITY, AND OUR OWN MANAGEMENT BY OBJECTIVE SYSTEM FOR RULE AND POLICY REVIEW. AT THAT TIME WE SET UPON AN AMBITIOUS PLAN TO REVIEW EVERY RULE AND POLICY OF OUR AGENCY WITHIN 3 YEARS. AT THE COMPLETION OF EACH STAGE OF REVIEW, A NOTICE WAS ISSUED REQUESTING PUBLIC COMMENT ON THE ECONOMIC IMPACT THOSE RULES WERE HAVING ON SMALL ENTITIES. WHEN COMMENTS CONCERNING THE IMPACT OF A PARTICULAR RULE WERE RECEIVED, THE APPROPRIATE OPERATING BUREAU WOULD MAKE RECOMMENDATIONS WHETHER AND TO WHAT EXTENT A MODIFICATION WAS NEEDED. WE ARE ENORMOUSLY PLEASED TO REPORT THAT WE HAVE VIRTUALLY COMPLETED THIS COMPREHENSIVE REVIEW OF OUR RULES FIVE YEARS AHEAD OF THE STATUTORY DEADLINE.

TO ENSURE THAT NEW RULEMAKINGS DO NOT IMPOSE UNNECESSARY PAPERWORK BURDENS ON SMALL BUSINESSES, THE FCC HAS ESTABLISHED PROCEDURES FOR ALL COMMISSION BUREAUS AND OFFICES TO FOLLOW IN THE PREPARATION OF ALL RULEMAKING ITEMS. THOSE PROCEDURES REQUIRE OUR EMPLOYEES TO PREPARE AN INITIAL REGULATORY FLEXIBILITY ANALYSIS FOR EACH RULEMAKING WE COMMENCE, UNLESS WE CERTIFY PURSUANT TO SECTION 605(b) OF THE ACT THAT OUR CONTEMPLATED ACTION WILL HAVE NO SIGNIFICANT ECONOMIC IMPACT ON

SMALL ENTITIES. IF THE NOTICE REQUIRES AN INITIAL ANALYSIS, A FINAL ANALYSIS IS PREPARED FOR THE REPORT AND ORDER. THESE ANALYSES OR CERTIFICATIONS ARE THEN REVIEWED BY DESIGNATED INDIVIDUALS IN THE VARIOUS BUREAUS OR OFFICES OF THE COMMISSION WHO ARE FAMILIAR WITH THE REQUIREMENTS AND PURPOSES OF THE ACT. IN ADDITION, THE OFFICE OF GENERAL COUNSEL REVIEWS EACH RULEMAKING ITEM TO ENSURE THAT A REGULATORY ANALYSIS HAS BEEN PREPARED WHEN NECESSARY AND THAT IT IS LEGALLY SUFFICIENT.

TO GIVE SMALL ENTITIES NOTICE OF OUR CONTEMPLATED ACTIONS, WE SUBMIT OUR SEMI-ANNUAL REGULATORY FLEXIBILITY AGENDA TO OMB FOR PUBLICATION IN THE FEDERAL REGISTER AS PART OF THE UNIFIED AGENDA. IN ADDITION, THE COMMISSION'S CONSUMER ASSISTANCE AND SMALL BUSINESS DIVISION OF THE OFFICE OF CONGRESSIONAL AND PUBLIC AFFAIRS HAS ATTEMPTED TO IDENTIFY PUBLICATIONS THAT REACH SMALL ENTITIES AND PROVIDE THEM WITH COPIES OF THE SEMI-ANNUAL REGULATORY FLEXIBILITY AGENDAS IN ORDER TO ENCOURAGE PUBLIC COMMENT.

IN OUR EXPERIENCE, FEW ENTITIES HAVE COMMENTED ON OUR REGULATORY FLEXIBILITY AGENDA OR THE REGULATORY FLEXIBILITY ANALYSES CONTAINED IN OUR RULEMAKING NOTICES. INSTEAD, INFORMATION ABOUT THE IMPACT OF OUR RULEMAKING PROPOSALS IS GENERALLY CONTAINED IN COMMENTS DIRECTED TO THE SUBSTANCE OF PARTICULAR RULEMAKING PROPOSALS. IN ASSESSING THE IMPACT ON SMALL ENTITIES, THE COMMISSION LOOKS TO THESE COMMENTS AND ALSO

RELIES ON ITS STAFF'S EXPERIENCE AND SPECIAL KNOWLEDGE OF THE REGULATED INDUSTRY, AS WELL AS ANY DATA ALREADY IN THE COMMISSION'S FILES.

ALTHOUGH OUR REGULATORY FLEXIBILITY ANALYSES DO NOT THEMSELVES LEAD TO MUCH COMMENT, WE ARE ACUTELY AWARE OF THE NEEDS OF SMALL ENTITIES. DURING THE LAST FIVE YEARS WE HAVE SOUGHT TO PROVIDE FOR SMALL ENTITIES THROUGH THE IMPLEMENTATION OF TWO IMPORTANT COMMISSION POLICY OBJECTIVES: 1) THE ELIMINATION OF UNNECESSARY GOVERNMENT REGULATION WHERE POSSIBLE, AND 2) THE PROMOTION OF FREE MARKETPLACE COMPETITION. IN MANY INSTANCES, OUR RECENT PROCEEDINGS HAVE ELIMINATED REGULATORY BURDENS AND CREATED NEW BUSINESS OPPORTUNITIES FOR MANY SMALL ENTITIES.

FOR EXAMPLE, SINCE 1981, THE FCC HAS ELIMINATED 80% OF ITS PAPERWORK BURDEN ON REGULATED INDUSTRIES. RENEWALS FOR MANY BROADCAST STATIONS ARE NOW THE SIZE OF A POSTCARD. THE COMMISSION HAS ALSO ELIMINATED UNNECESSARY REPORTING REQUIREMENTS, SUCH AS THE FINANCIAL REPORTS REQUIRED OF OUR BROADCAST AND RADIO COMMON CARRIER LICENSEES. THE COMMISSION HAS ACTED TO DEREGULATE SUBSCRIPTION TELEVISION, AUXILIARY TELEVISION STATIONS, AND NON-COMMERCIAL RADIO AND TELEVISION, AND CONTINUES TO MAKE PROGRESS IN CREATING AN UNREGULATED MARKETPLACE FOR TELEPHONE EQUIPMENT AND INTERSTATE TELEPHONE SERVICE. COMPLIANCE WITH TECHNICAL REQUIREMENTS CAN INCREASINGLY BE SELF-CERTIFIED, AND LICENSING TERMS ARE NOW LONGER. FINANCIAL SHOWINGS BY OUR LICENSEES HAVE BEEN ELIMINATED IN MANY SERVICES. GENERALLY, THE

COMMISSION REQUIRES FINANCIAL SHOWINGS ONLY WHERE IT IS NECESSARY TO ENSURE THAT VALUABLE SPECTRUM IS NOT TIED UP FOR YEARS BY AN APPLICANT WHO LACKS THE FINANCIAL RESOURCES TO UTILIZE IT. AS A DIRECT RESULT OF THESE AND OTHER DEREGULATORY ACTIONS, SIGNIFICANT REGULATORY BURDENS HAVE BEEN LIFTED FROM SMALL ENTITIES.

DURING THIS SAME TIME PERIOD, THE COMMISSION HAS INTRODUCED MANY NEW SERVICES, SUCH AS LOW POWER TELEVISION, TELETEXT, DIGITAL ELECTRONIC MESSAGE SERVICE AND CELLULAR RADIO TELEPHONE SYSTEMS. MANY OF THESE ARE IDEALLY SUITED FOR SMALL BUSINESSES. THUS, OUR RECENT ACTIONS HAVE ALSO MADE POSSIBLE NEW AVENUES OF BUSINESS OPPORTUNITY FOR SMALL ENTITIES.

OUR ACTIONS CONCERNING THE PRIVATE RADIO SERVICES ARE WORTHY OF SPECIAL NOTE BECAUSE MANY SMALL BUSINESSES USE THESE SERVICES. WE HAVE MADE MORE CHANNELS AVAILABLE, ELIMINATED REGULATIONS, AND REDUCED PROCESSING TIME. THE PRIVATE LAND MOBILE RADIO SERVICE HAS RECEIVED 600 NEW CHANNELS OVER THE LAST FIVE YEARS. ANOTHER 40 CHANNELS HAVE BEEN MADE AVAILABLE FOR PRIVATE CARRIER PAGING SERVICES. WE HAVE ALSO INCREASED THE OPPORTUNITIES FOR SHARING IN BOTH THE LAND MOBILE AND MICROWAVE SERVICES SO THAT SMALL ENTITIES CAN LEASE TIME ON EXISTING FACILITIES, RATHER THAN INCUR THE EXPENSE OF BUILDING THEIR OWN. WE HAVE MODIFIED OR ELIMINATED NUMEROUS RESTRICTIVE RULES. FOR EXAMPLE, IN THE PRIVATE LAND MOBILE RADIO SERVICES WE HAVE RELAXED RESTRICTIONS GOVERNING INTERCONNECTION

TO THE PUBLIC SWITCHED TELEPHONE NETWORK AND PERMISSIBLE COMMUNICATIONS. IN THE MARITIME RADIO SERVICE WE VERY RECENTLY REDUCED THE SIZE OF THE RULES BY 40%. THIS REVISION SHOULD NOT ONLY ELIMINATE 2,880 BURDEN HOURS OF RECORD KEEPING REQUIREMENTS, BUT WILL MAKE THE RULES MUCH EASIER TO USE. IN THE PAST FEW YEARS, SIMILAR REDUCTIONS HAVE TAKEN PLACE IN OTHER SERVICES. FINALLY, WE HAVE IMPROVED OUR LICENSING PROCEDURES SO THAT FASTER SERVICE IS PROVIDED TO THE PUBLIC. FOR INSTANCE, IN 1984 OUR PROCESSING STAFF IN GETTYSBURG PROCESSED 352,303 LAND MOBILE AUTHORIZATION REQUESTS, OR 24% MORE THAN IN 1981, WHILE REDUCING THE OVERALL PROCESSING TIME FOR LAND MOBILE RADIO FROM APPROXIMATELY 60 DAYS TO LESS THAN 30 DAYS. IN THE PRIVATE OPERATIONAL-FIXED MICROWAVE SERVICE, PROCESSING TIME HAS BEEN REDUCED FROM 180 DAYS IN 1981 TO UNDER 50 DAYS TODAY.

IN CONCLUSION, WE BELIEVE THAT THE GOALS OF THE REGULATORY FLEXIBILITY ACT IN MANY WAYS PARALLEL THE PUBLIC INTEREST GOALS OF THE COMMUNICATIONS ACT, FOR BOTH ARE CONCERNED WITH THE QUALITY OF SERVICE TO THE PUBLIC. OUR EXPERIENCE HAS BEEN THAT, WHEN SMALL BUSINESSES AND PRIVATE CITIZENS FEEL THEIR INTERESTS ARE AT JEOPARDY, THEY MAKE THEIR CONCERNS KNOWN TO US. IN SOME CASES THEY DO SO BY COMMENTING ON THE SUBSTANCE OF OUR PROPOSALS DIRECTLY OR THROUGH ASSOCIATIONS TO WHICH THEY BELONG. IN SOME CASES THEY WRITE TO US ABOUT THEIR CONCERNS. FOR EXAMPLE, WE RECEIVED THOUSANDS OF LETTERS CONCERNING THE DIVESTITURE OF AT&T ORDERED BY THE ANTITRUST COURT AND HUNDREDS

OF LETTERS FROM SMALL OPERATIONS LIKE LIBRARIES AFFECTED BY INCREASES IN AT&T'S PRIVATE LINE RATES. SUCH COMMENTS, HOWEVER, OFTEN APPEAR TO BE GENERATED BY PRESS REPORTS RATHER THAN BY OUR REGULATORY FLEXIBILITY ANALYSES.

WE TAKE OUR PUBLIC INTEREST REPONSIBILITIES VERY SERIOUSLY AND ARE CONSTANTLY STRIVING TO ENHANCE THE BENEFITS TO SMALL ENTITIES. BY IMPLEMENTING OUR AFOREMENTIONED POLICIES, WE HAVE OPENED A WHOLE NEW RANGE OF OPPORTUNITIES FOR SMALL ENTREPRENEURS IN RADIO, TELEVISION, CABLE AND OTHER COMMUNICATIONS BUSINESSES, AND WE HAVE INCREASED THE AVAILABILITY OF REASONABLY PRICED TELECOMMUNICATIONS SERVICES BENEFITING SMALL ENTITIES IN OTHER BUSINESSES. TECHNOLOGY CONTINUES TO ADVANCE RAPIDLY AND THE NEW SERVICES SPAWNED BY THIS TECHNOLOGY ARE PROLIFERATING. THE COMMISSION WILL CONTINUE TO RESPOND BY ENCOURAGING THE ENTRY OF SMALL BUSINESSES INTO THE MARKETPLACE AND REMOVING UNREASONABLE RESTRICTIONS AND PAPERWORK BURDENS FROM EXISTING SERVICES.

THANK YOU FOR THE OPPORTUNITY TO PRESENT THE FCC'S VIEWS CONCERNING THE EFFECT OF THIS ACT. WE WILL NOW BE HAPPY TO ANSWER ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE CONCERNING THIS TESTIMONY.

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Mr. SKELTON. I wish you had been here earlier. Rather than go through a third party, you could have heard some of our friends from out in Missouri and elsewhere comment about some of the problems they are having.

Be that as it may, you will be aware of them in a few moments. Mr. Coble.

Mr. COBLE. Chairman Fowler, thank you for being with us.

Prior to your arrival, one of the witnesses indicated that it was his belief that the cost should not exceed the benefits; and I asked him to elaborate in some detail on that, and he gave us a horrifying example how sometimes bureaucratic rules and regs do, indeed, exceed the benefits.

Some telephone companies in my district have expressed concern regarding FCC regulations of these small companies. I have been told that two of the FCC's principal objectives are to establish a competitive marketplace, one; and to eliminate unnecessary regulations, two.

I certainly would put those two on my front burner; but, as to the second one, it flies into the teeth of the earlier complaint that we had.

I think you touched on it, Mr. Chairman, but if you could, in a very brief way, share with us the actions, if any, that the FCC has taken to implement these goals, and how have these actions affected small telephone companies and their subscribers.

Mr. FOWLER. Yes, sir; I will be glad to, Mr. Coble.

I think it is important to point out, first of all, what we are regulating here. Even though they are small businesses, many of the telcos that are involved, and some that have testified here today, would be the first to recognize that they are still monopolies in their area in providing both local telephone service and providing what we call access services—that is, the access to their subscribers by the long-distance telephone companies.

We have to keep that firmly in mind, because, absent certain regulatory tools, a monopoly has the ability to essentially set its own prices, and determine its own output.

Mr. SKELTON. You used the term "monopoly," and I am sure that might be a monopoly in Rock Port, MO; but that is not the term that is used in the statute. The term that is used in the statute is "dominant."

Mr. FOWLER. Yes, sir.

Mr. SKELTON. And dominant—the company in Rock Port, MO, is not dominant in its field; it is not a geographical dominance; it is a nationwide dominance, and the Small Business Regulation refers to this:

> A concern is not dominant in its field of operation when it does not exercise a controlling or a major influence on a national basis in the kind of business activity in which a number of business concerns are primarily engaged.

So, Mr. Chairman, you are using the term "monopoly" on a geographical base, when you should be using the term "dominant," which really means on a national basis.

So, I think you are using the wrong test. Now, excuse me for interrupting, but I feel very strongly that you should address this issue while you are discussing it.

Mr. **Fowler**. I have not heard this language before, and is that from the Regulatory Flexibility Act?

Mr. **Skelton**. The SBA regulations, page 293, section 121.4—121.3, excuse me. I will be glad to give it to you.

Mr. **Fowler**. We are unaware of this. Frankly, I would like to——

Mr. **Skelton**. We will get it to you.

Mr. **Fowler**. Yes, sir.

Mr. **Skelton**. Then, have you been following the term "monopoly," rather than the term "dominance"?

Mr. **Fowler**. We looked at the term "small entities," I believe.

Mr. **Skelton**. "Small entities."

Mr. **Fowler**. Excuse me, let me just finish here.

Mr. **Skelton**. OK, too many chiefs here. Go ahead.

Mr. **Fowler**. As I remember—I would have to go back to my notes here, but the Regulatory Flexibility Act requires us to certify that our actions do not have a significant effect on a substantial number of small entities.

And small entity is defined under the act as a business that is not dominant in its field of operation, which is what I was going to say.

Mr. **Skelton**. So, we have a disagreement on that?

Mr. **Fowler**. I think it is clear, Mr. Chairman, that a small telephone company is dominant in its field of operation. It is the only game in town—to provide local telephone service and to provide long-distance access service.

And that is the reason why the Commission, looking at the act, made the determination that telcos, including small rural telcos, do not fall within the definition of a small entity.

It is not that we are not trying to be as deregulatory as we can, but we do have to recognize the need to protect rate payers. We do have certain obligations there as well.

Mr. **Skelton**. We will get to that in just a moment. I was rude in interrupting, so I will let you go on and proceed, and then we will get to this again.

Thank you.

Mr. Coble.

Mr. **Coble**. Thank you, Mr. Chairman.

Mr. **Skelton**. Do you have further questions?

Mr. **Coble**. Are you finished?

Mr. **Fowler**. I was going to say that there are a number of things that we have done, to answer your question, sir.

I indicated that we have eliminated a considerable amount of paperwork and certain forms that had to be filed.

Mr. **Coble**. And I realized, Mr. Chairman, that you touched on some of this——

Mr. **Fowler**. Yes, sir.

Mr. **Coble** [continuing]. In your testimony. I just thought if you wanted to highlight that again.

Mr. **Fowler**. Well, I will highlight several things that we have done. We have said that the local carriers may use what we call an average schedule system of compensation. This means that where we require cost studies to be done by telephone companies, in order to determine what their interstate costs are, to determine what kind of compensation they get from the NECA pool, the National Exchange Carriers Association pool, we have said that, if they wish, they do not have to do these cost studies. They can elect to be an average schedule company, which means that they are then paid on the basis of cost studies, which are filed by others who choose to do so.

And we assume that, for purposes of determining their compensation, they are similar to those who do file the cost studies, and, therefore, that is the way we determine what their payments are.

That relieves them of a tremendous amount of paperwork. We are, in addition, looking right now at a petition that has been filed by the United States Telephone Association that asks us to consider some significant deregulation of the small telephone companies in the area of tariff regulation and we are actively working on that right now.

That petition was filed not too long ago, and I asked the staff to put it on a fast track, because I do have a sense that in some areas we could impose less regulations on the small telcos than we do now.

I also have to say that there may be ways to do this without finding that they are not dominant or finding that they are not monopolies, because I do not believe we could make that kind of finding.

Mr. Coble. Mr. Chairman, a couple of more questions, if I may.

I am from the rural South, and in the rural South, we have a saying that "You can attract more bees with honey than you can with vinegar."

So, let's use the honey approach for a minute. Would you consider an informal meeting with the Commission, with members of the subcommittee, and with representatives of small telephone companies and small entities to discuss their concerns?

Mr. Fowler. Indeed, I would be delighted.

Mr. Coble. It seems to me that that might provide a good forum, Mr. Chairman, and then perhaps some of these problems would be aired, and resolved, hopefully.

One final question, Mr. Chairman, and you touched on it in your question to the chairman earlier.

We have been told previously that in 1980, I think the FCC decided that small telephone companies were dominant in their field. That is the question that Chairman Skelton referred to earlier.

Do you have any plans to review that decision since the breakup of the Bell System?

Mr. Fowler. To answer your question directly, yes; we will be reviewing that question, because it is raised in the United States Telephone Association petition asking for more streamlined and reduced regulation of small telephone companies.

But I do not personally believe—I do not hold out much hope that we can find them not to be dominant for the reasons that I indicated earlier.

These local telephone companies are monopolies in the provision of local telephone service, and long-distance access service. That is my view. Now, we will still give it a hard look, but having said that I again want to make the point, sir, that it may still be possible to reach the desired result—that is, to lessen the regulation of the small telephone companies without having to overturn the finding that they are dominant.

Mr. Coble. Thank you, Mr. Chairman, for appearing before us.

And, Mr. Chairman, for what it's worth, I would like to promote and endorse the informal meeting type proposal, if that meets with your approval.

Mr. Skelton. I think that is some first-class North Carolina honey. [Laughter.]

Mr. Fowler. Yes.

Mr. Skelton. And we appreciate that suggestion, and I am sure that you will follow through, sir.

Mr. Fowler. Chairman Skelton, one thing I wanted to say is that I personally am not used to criticism because we did not deregulate enough—that we have been too regulatory. This is my first occasion to face that.

So, I will certainly——

Mr. Skelton. You can rectify that very quickly.

Mr. Fowler. I will certainly want to give this a hard look, and that is why the idea of the discussions that you have suggested is very well taken.

Mr. Skelton. We do appreciate that.

In the absence of Mr. Ireland, we are going to ask Mr. Lynch to ask some questions.

Mr. Lynch. No questions.

Mr. Skelton. We covered it.

Let me be a country lawyer with you, if I may.

In the Regulatory Flexibility Act—you may wish to make note of this, counsel—there is section 601, "Definitions." Subparagraph 4 is the term "small organization," means "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field, unless the agency establishes opportunity for public comment one or more definitions of such terms which are appropriate to the activities of the agencies," et cetera.

I understand there is a case—I do not have it, I understand there is a case that points out that "dominant in its field," does not mean "local and geographic." It means on a national basis.

I want to ask my staff to supply that case for you. Hopefully, we can find it before the sun sets.

Yes?

Mr. Orban. We do have a list of cases here, which say that "dominance" refers to "within an SIC code," that is all businesses within a similar industry.

We have a line of cases going back to 1970 up through 1980, which I would be happy to enter into the record.

Mr. Skelton. Why don't you do that right now?

Mr. Orban. Yes; these are appeals from the Size Standard Board made from 1970, and they are by number, and I would like to offer this, Mr. Chairman, for the record, and I will supply a copy to the Chairman of the FCC.

Mr. Skelton. Please.

[The information referred to follows:]

D. MISCELLANEOUS DOMINANCE CASES.

"The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of the act if it is actually a small business enterprise." (H.R. Rep. No. 494, 83d Cong., 1st Sess. 10 (1953) in discussion re small enterprises which manufacture items not manufactured by other companies.)

Appeal #206, 10-20-66; Appeal #398, 12-15-69; Appeal #431, 7-29-70; Appeal #548, 3-22-72

• • • • •

Aircraft transparencies are not a field of operation as contemplated by the dominance regulation. The product involved is only one of many included in the relevant field of operation. Even if it were a separate field, the company in question was not dominant.

Appeal #402, 2-12-70

• • • • •

Dominance must be established with respect to all activities or products included within the SIC applicable to the procurement and is not limited to the particular products or services involved in the procurement.

Appeal #431, 7-29-70; Appeal #449, 9-22-70

• • • • •

Appellant contended that the two companies in question were dominant with respect to approximately 80 items in the appropriate SIC. The Board stated that the question of dominance applies to a concern's position in a particular industry category and not with respect to one product or commodity, unless that product or commodity has a sufficient economic impact to be regarded as a separate industry. Even if the items here were regarded as separate, there still was no dominance.

Appeal #453, 10-7-70. See also #398, 12-15-69; Appeal #862, 3-10-76.

Where the Board rejected appellant's contention that the appropriate "field of operation" for determining possible "dominance" was the narrow category of desk calendars and/or their refils, and appellant alleged no dominance by the company in question of the entire group of items classified under the applicable SIC classification (2782), the Board found no dominance within the field of operation.

Appeal #732, 5-2-75

* * * * *

Dominance plus specific criteria in terms of financial figures are needed when determining size for the purpose of assistance by small business investment companies.

Appeal #986, 2-1-77

* * * * *

Dominance must be established with regard to the SIC industry applicable to the product procured and not limited to the specific industry definition for the product procured, unless there is a showing that the more specific industry definition claimed for the product procured has sufficient economic impact to be regarded as a separate industry. A specific industry, the value of whose shipments accounted for only 11.2% of the total value of the shipments in the SIC industry, was not of sufficient significance to warrant a special definition. The concern was not dominant in the SIC industry.

Appeal #1378, 9-19-80

No. 748

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF THE SIZE APPEAL OF NARTRON CORPORATION

The Size Appeals Board, having considered the appeal of Nartron Corporation (Nartron), Reed City, Michigan, from the determination of the District Director of the Indianapolis District Office of the Small Business Administration (SBA), that Meridian Industries, Inc. (Meridian), is a small business concern for the purpose of award of the set-aside portion of a procurement of turn signal kits under Solicitation No. DAAE07-72-B-0446, a labor surplus area set-aside issued by the U. S. Army Tank-Automotive Command, finds that:

A. Meridian was the apparent successful bidder for the set-aside portion of the procurement at the time of the bid opening on December 22, 1971. Another bidder, Nartron, protested the size of Meridian on the grounds that it is the dominant company in the manufacture of turn signal switch kits, and that the number of employees of Meridian and affiliates exceeds the size standard of 1,000 employees.

B. The District Director of SBA determined that Meridian was a small business concern based upon the following conclusions. Meridian is in fact not dominant in the manufacture of turn signal switch kits. Furthermore, dominance in a field of operation, rather than in the manufacture of a product, is required under the Small Business Act for a finding that a concern is not small by reason of dominance. The total number of employees of Meridian and affiliates during the pay period ending nearest the last day of the third month in each calendar quarter for the preceding four quarters was 666. The allegation that Meridian had gross sales in 1970 in excess of $30 million is irrelevant because the size standard under Census Classification No. 3717, Motor Vehicles and Parts, is 1,000 employees. The allegation that the Briggs family controls many concerns, the total number of employees of which exceeds the size standard herein, has been refuted by information contained in the affidavit of Basil M. Briggs.

C. In its appeal, Nartron maintains that the size determination of the District Office conflicts with the policy of the Small Business Act, that the Director erred in determining that Meridian was independently owned and operated, that Meridian is dominant in its field of operation, that the Director erred in finding that Meridian had less than 1,000 employees, and that the size standard for motor vehicle parts industries is unreasonable.

D. Section 3 of the Small Business Act of 1958, reads as follows:

> "For the purposes of this Act, a small-business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria the Administrator, in making a detailed definition may use these criteria, among others: Number of employees and dollar volume of business. Where the number of employees is used as one of the criteria in making such definition for any of the purposes of this Act, the maximum number of employees which a small-business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and to take proper account of other relevant factors."

E. In implementation thereof, Section 121.3-8 of the SBA Rules and Regulations reads in part as follows:

> "A small business concern for the purpose of Government procurement is a concern, including its affiliates, which is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts and can further qualify under the criteria set forth in this section. When computing the size status of a bidder or offerer, the number of employees, annual receipts, or other applicable standards of the bidder or offerer and all of its affiliates shall be included. . . .
>
> (b) Manufacturing. Any concern bidding on a contract for a product it manufactured is classified:. . .
>
> (2) As small if it is bidding on a contract for a product classified within an industry set forth in Schedule B of this part and its number of employees does not exceed the size standard established for that industry . . ."

F. Schedule B, Industry Employment Size Standards For The Purpose of Government Procurement (Manufacturing), lists Census Code 3717, which includes among the class of products "Motor vehicles and parts" with a size standard of 1,000 employees.

G. Nartron's contention that the size determination of the District Director conflicts with the policy of the Small Business Act, because Meridian has large gross annual receipts and allegedly could not qualify for an SBA loan, is irrelevant, since the size standard for the procurement is 1,000 employees.

H. The evidence indicates that Meridian is dominant neither in the production of turn signal kits nor in the production of electrical equipment for military vehicles. Furthermore, the following statement makes it clear that it is not the legislative intent that a firm be rendered ineligible because it is dominant with respect to one product or item:

> ". . . . With respect to nondominance in its field, the committee does not intend to exclude business enterprises which are actually small-business enterprises that manufacture an article or commodity which is not manufactured by any other business. The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of this act if it is actually a small-business enterprise."(underscoring supplied) See Report to the House Banking and Currency Committee (H.R. 494, 83rd Cong. 1st Session, 5-28-53, p. 10).

I. The question of whether the size standard for motor vehicle parts is unreasonable is not for determination by the Size Appeals Board.

J. The evidence indicates that Basil M. Briggs, Chairman of the Board, owns 13.9% of the voting stock of Meridian, that his brother, James R. Briggs, a director, owns 7.33% of the voting stock, that his brother Walter O. Briggs, III, a director, owns 11.38% of the voting stock, that A. J. Anziek, a director, owns 7.36% of the voting stock, that Russell S. Knecht, a director, owns 5.6% of the voting stock, and that all other stockholders have lesser individual holdings.

K. In an affidavit dated January 18, 1972, Basil M. Briggs states that he no longer has any interest in Buhl Realty, that he is a partner in a law firm which has one employee, that he is a director and owns a nominal stock interest in Patrick Petroleum, in four oil wells, and in Bank of the Commonwealth, that he is a director and owns no stock in Creative Capital Corporation, a small business investment company. The Board concludes that Basil M. Briggs has the power to control only one of the above concerns, namely the law firm.

L. Said affidavit of Basil M. Briggs also states that the other members of his family, specifically his brothers, Walter O. and James R. Briggs, and his mother, Mrs. Laura M. Briggs, do not have stockholdings in excess of 1% in any company other than Meridian, except that Walter O. Briggs is the majority stockholder in Equity Management and Research, Inc., which employs four people.

M. Although the Andy Gard proxy statement of September 1, 1971, indicates that Meridian and affiliates had 1,030 employees, the evidence indicates, under the definition in Section 121.3-2(t) of the SBA Rules and Regulations, that the total average number of employees of Meridian and affiliates during the pay period ending nearest the last day of the third month in each calendar quarter for the preceding four quarters, including the employees of acquired affiliates during the entire applicable accounting period, and excluding the employees of former affiliates, was 719.

N. The Board therefore finds that Meridian is a small business concern for the purpose of this procurement.

Accordingly, the appeal is denied.

Date decided: March 22, 1972

Anthony G. Chase, Chairman

Jack Eachon, Jr.

Clyde B. Bothmer

Emanuel W. Sandberg, Jr.

Claude Alexander

No. 431

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF AMERICAN BATTERY ACID CORPORATION

The Size Appeals Board, having considered the appeal of American Battery Acid Corporation, Memphis, Tennessee, from a determination of the Small Business Administration's Atlanta Regional Office that Scholle Atlanta Corporation, College Park, Georgia, is a small business concern for purposes of award of a contract under Invitation for Bids No. DSA 400-70-B5927 for supply of sulfuric acid electrolyte, issued by Defense General Supply Center, Richmond, Virginia, finds that:

A. A concern is small for purposes of the subject IFB if it has fewer than 1,000 employees. It is not disputed that Scholle Atlanta Corporation has fewer than 1,000 employees.

B. American Battery Acid Corporation alleges that Scholle Atlanta Corporation and its affiliates supply a minimum of 80 percent of the electrolyte for dry charge lead batteries sold in the United States, exclusive of Defense Supply Agency requirements; that it does a nationwide business through large merchandisers and is, therefore, dominant in its field of operation. As such it is alleged to be a large business concern within the meaning of the Small Business Act and Regulation and ineligible to bid on this procurement.

C. Section 121.3-2(r) of the Small Business Size Standards Regulation provides as follows:

> "A concern is 'not dominant in its field of operation' when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration shall be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity."

D. Standard Industrial Classification Code 2819, the applicable product classification for this procurement, includes a variety of industrial chemicals. To establish that Scholle Atlanta Corporation and its affiliates are dominant within the meaning of Section 121.3-2(r) of the size regulation it would be necessary to show that the Scholle affiliates are dominant with respect to the entire industry classification and not merely with respect to one product within the industry. The legislative history of the Small Business Act reveals that Congress considered the question of dominance in the manufacture of a particular product, as distinguished from dominance in the industry, and stated as follows:

> " . . . With respect to nondominance in its field, the Committee does not intend to exclude business enterprises which are actually small business enterprises that manufacture an article or commodity which is not manufactured by any other business. *The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of this Act if it is actually a small business enterprise.*" (Underscoring Supplied)

E. Electrolyte, the product here in question, is basically sulfuric acid and water. SIC 2819, *Industrial Inorganic Chemicals, Not Elsewhere Classified*, which includes sulfuric acid, lists in excess of 150 different products. Thus, it alone cannot be considered a "field of operation" for the purpose of establishing dominance. Moreover, the latest figures (1966) available show that aggregate sales of products in SIC 2819 were in excess of $3 billion. Sales from shipments of sulfuric acid for the same period were approximately $200 million. While Scholle concedes it distributes electrolyte nationally, there is no evidence to support a finding that it exercises a controlling influence in SIC 2819 industry; or that it has ownership or control of materials, processes, patents, license agreements and facilities. Based on the figures cited above, and assuming normal growth in the industry as a whole and the production of sulfuric acid in particular, Scholle and its affiliates would not be dominant, even if sulfuric acid were a separate field of operation.

F. For the foregoing reasons and since Scholle Atlanta Corporation and its affiliates has fewer than 1,000 employees, the Board finds that it is a small business concern for the purpose of this procurement.

Accordingly, the appeal is denied.

Decided: July 29, 1970

Einar Johnson, Chairman

Marshall Parker

Jack Bacton, Jr.

Wilfred J. Garvin

Attested:

Hilary Sandoval Jr.

Hilary Sandoval, Jr.
Administrator

No. 206

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF LAB-LINE INSTRUMENTS, INC.

The Size Appeals Board, having considered the appeal by Lab-Line Instruments, Inc. Melrose Park, Illinois, from the September 2, 1966 determination by the Small Business Administration Boston Regional Office that International Equipment Company, Needham Heights, Massachusetts, is a small business concern for the purpose of award under Invitation for Bids No. DSA-120-67-B-0230, issued by the Defense Personnel Support Center, Philadelphia, Pennsylvania, finds that:

A. The procurement in question is for laboratory centrifuges, Size 2, 110 volt, 60 cycle, AC. Stock No. 6640-412-9300.

B. Laboratory centrifuges are classified in Standard Industrial Classification Industry No. 3811, Engineering, laboratory, and scientific and research instruments and associated equipment.

C. A small business concern for the purpose of bidding on a contract for laboratory centrifuges is a concern which, together with its affiliates, is independently owned and operated, is not dominant in the field of operation in which it is bidding, and whose number of employees does not exceed 500 persons. See Section 121.3-8(b)(4) of the Small Business Size Standards Regulation.

D. The Small Business Administration Boston Regional Office determined that International Equipment Company, together with its only affiliate, IEC Corporation, has less than 500 employees and therefore that it is a small business concern for the purpose of award under IFB No. DSA-120-67-B-0230. Lab-Line Instruments, Inc. does not dispute the finding of the total number of employees of International Equipment Company and its affiliates, but alleges that International Equipment Company is dominant in the field of operation in which it is bidding, to-wit, the manufacture of the type centrifuge being supplied under this particular procurement. Therefore, it alleges that International Equipment Company should not be considered to be a small business concern for the purpose of the procurement in question.

E. Section 121.3-2(p) of the Small Business Size Standards Regulation provides that:

> A concern is "not dominant in its field of operation" when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration shall be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity.

F. The Board has concluded that the applicable field of operation is Standard Industrial Classification Industry No. 3811, Engineering, laboratory and scientific and research instruments and associated equipment, rather than being limited to the manufacture of the laboratory centrifuges, Size 2, 110 volt, 60 cycle, AC. Stock No. 6640-412-9300. In this connection, the Board notes in the legislative history of the Small Business Act, the following statement:

> " . . . . With respect to nondominance in its field, the committee does not intend to exclude business enterprises which are actually small-business enterprises that manufacture an article or commodity which is not manufactured by any other business. The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of this act if it is actually a small-business enterprise. (underscoring supplied) See Report to the House Banking and Currency Committee (H.R. 494, 83rd Cong. 1st Session, 5-28-53, p. 10).

G. In the absence of any information to show that International Equipment Company, by reason of its volume of business, number of employees, financial resources, etc., is dominant in Standard Industrial Classification Industry No. 3811, and in view of the fact that according to 1958 census statistics, there were twenty companies in this industry with 2500 or more employees, whereas International Equipment Company has fewer than 500, the Board has determined that International Equipment Company cannot be considered as exercising a controlling or major influence on a national basis in Standard Industrial Classification Industry No. 3811 and, therefore, is not dominant in this field of operation. Therefore, the Board has determined that International Equipment Company is a small business concern for the purpose of the procurement in question.

Accordingly, the appeal is denied.

Decided: October 20, 1966

Padraic P. Frucht, Chairman

Irving Maness

Adopted:

10-20-66

Bernard L. Boutin
Administrator

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF THE SIZE APPEAL OF TRANS-ANGELES LOG AND TIMBER CO., INC.

The Size Appeals Board, having considered the appeal of Trans-Angeles Log and Timber Co., Inc. (TLT), Seattle, Washington, from the determination of the Small Business Administration's Seattle Regional Office that TLT is not a small business concern for the purpose of award of two set-aside timber sales, No. 00441-1 (Section 23) and No. 00442-9 (Frog Mountain), by the Department of Agriculture Forest Service, Seattle, Washington, finds that:

A. Albert J. Firchau owns 100 percent of the stock of TLT. He also owns 100 percent of the stock of Independent Loggers and Contractors, Inc. (ILC). In Decision No. 393, November 3, 1969, the Size Appeals Board determined that ILC was affiliated with a creditor, Gunderson Brothers Engineering Corporation (Gunderson), a large business concern, because Mr. and Mrs. Firchau, ILC, and other Firchau-owned corporations, other than TLT, gave Gunderson the following documents and rights, under security and pledge agreements to secure a demand note:

1. A security interest in certain road building and logging equipment;

2. A mortgage on real estate owned by Mr. and Mrs. Firchau;

An assignment of the interest of the Firchaus in a certain option for the sale of real estate;

An assignment of Albert Firchau's interest as the beneficiary of an estate;

An assignment of rights and interests under certain contracts;

A pledge of all capital stock in specified corporations, not including TLT;

An assignment of all life insurance policies insuring the life of Albert Firchau;

Written resignations of all directors of certain corporations not including TLT;

The right to designate an employee to review the activities of Mr. Firchau and ILC, which employee would have joint signature authority on all business accounts.

B. By letter dated September 29, 1969, Gunderson released all of its interest in the stock of ILC, without prejudice and without effect upon other rights and securities held by Gunderson. This date was ten days after the opening of bids on the two sales involved in this appeal. The bid opening date was September 19, 1969.

C. Section 121.3-2(a) of the Small Business Size Standards Regulation defines "affiliates" as follows:

> "Concerns are affiliates of each other when either directly or indirectly (1) one concern . . . controls or has the power to control the other, or (2) a third party or parties . . . controls or has the power to control both. In determining whether concerns are independently owned and operated and whether or not affiliation exists, consideration shall be given to all appropriate factors, including common ownership, common management, and contractual relationships."

D. While TLT is not a party to the security and pledge agreements cited in Paragraph A herein, the effect of the agreements is to give Gunderson a power to control Mr. Firchau, the president and sole stockholder of TLT, and, through Mr. Firchau, power to control TLT.

E. Accordingly, TLT was affiliated with Gunderson at the time of bid opening and was not a small business at that time.

The appeal is denied.

Decided: December 31, 1969

W D Brewer
W. D. Brewer, Chairman

Anthony S. Stasio
Anthony S. Stasio

R Hellman
Richard Hellman

James I Mills
James I. Mills

Adopted:

Hilary Sandoval Jr.
Hilary Sandoval, Jr.
Administrator

No. 449

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF SOMMERS BUILDING COMPANY

The Size Appeals Board, having considered the appeal of Sommers Building Company (Sommers) of Boulder, Colorado, from a determination by the Phoenix District Office of the Small Business Administration that Apache Flooring Company (Apache) of Scottsdale, Arizona, is a qualified small business concern for purposes of award of a contract under Invitation for Bids No. DABEO-70-B-0041, issued by Office of the Post Engineer, Fort Carson, Colorado, for repairs of warehouse flooring, finds that:

A. The procurement was 100 percent set aside for bidding by small business concerns.

B. A concern is small for purposes of IFB No. DABEO-70-B-0041 if it has average annual receipts of less than $7.5 million for the preceding three years.

C. Sommers was the apparent low bidder responding to the solicitation.

D. Apache submitted a bid in response to the solicitation but was not the apparent low bidder. Sommers, as a "bidder" within the meaning of the Small Business Size Standards Regulation, Section 121.3-5(a), which provides in part that "any bidder or offeror or other interested party may challenge the small business status of any other bidder . . .," submitted a protest challenging the small business status of Apache on the basis that (1) average annual receipts of Apache are in excess of $7.5 million, and (2) Apache is dominant in its field of operation.

E. The evidence submitted by Apache indicates that the average annual receipts of Apache for the previous three years were $3,256,5[illegible]1. Sommers provided no evidence to the contrary.

F. Dominance must be established with respect to all activities or products included within the Standard Industrial Classification (SIC) applicable to the procurement and is not limited to the particular products or services involved in the procurement. Decision of Size Appeals Board, American Battery Acid Corp., No. 431.

G. Census figures for 1967 indicate that there are 7,833 firms engaged in activities included with SIC 1752, the SIC code designated for the subject procurement, and that the aggregate gross receipts of all firms with the classification are $784 million so that the receipts of Apache represent less than 5 percent of the aggregate gross receipts of the firms included in the classification.

H. Since the average annual receipts of Apache do not exceed $7.5 million and since the average annual receipts of Apache are less than five percent (5%) of the aggregate receipts of firms included in the designated classification, the Board finds that Apache is a small business concern for purposes of the subject procurement and is not dominant in its field of operation.

Accordingly, the appeal is denied.

Decided: September 22, 1970

Einar Johnson
Einar Johnson, Chairman

Adopted:

Clyde Bothmer
Clyde B. Bothmer

Hilary Sandoval Jr.
Hilary Sandoval, Jr.
Administrator

Anthony S. Stasio
Anthony S. Stasio

Andrew A. Canellas
Andrew A. Canellas

No. 431

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF AMERICAN BATTERY ACID CORPORATION

The Size Appeals Board, having considered the appeal of American Battery Acid Corporation, Memphis, Tennessee, from a determination of the Small Business Administration's Atlanta Regional Office that Scholle Atlanta Corporation, College Park, Georgia, is a small business concern for purposes of award of a contract under Invitation for Bids No. DSA 400-70-B5927 for supply of sulfuric acid electrolyte, issued by Defense General Supply Center, Richmond, Virginia, finds that:

A. A concern is small for purposes of the subject IFB if it has fewer than 1,000 employees. It is not disputed that Scholle Atlanta Corporation has fewer than 1,000 employees.

B. American Battery Acid Corporation alleges that Scholle Atlanta Corporation and its affiliates supply a minimum of 80 percent of the electrolyte for dry charge lead batteries sold in the United States, exclusive of Defense Supply Agency requirements; that it does a nationwide business through large merchandisers and is, therefore, dominant in its field of operation. As such it is alleged to be a large business concern within the meaning of the Small Business Act and Regulation and ineligible to bid on this procurement.

C. Section 121.3-2(r) of the Small Business Size Standards Regulation provides as follows:

> "A concern is 'not dominant in its field of operation' when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration shall be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity."

D. Standard Industrial Classification Code 2819, the applicable product classification for this procurement, includes a variety of industrial chemicals. To establish that Scholle Atlanta Corporation and its affiliates are dominant within the meaning of Section 121.3-2(r) of the size regulation it would be necessary to show that the Scholle affiliates are dominant with respect to the entire industry classification and not merely with respect to one product within the industry. The legislative history of the Small Business Act reveals that Congress considered the question of dominance in the manufacture of a particular product, as distinguished from dominance in the industry, and stated as follows:

> " . . . With respect to nondominance in its field, the Committee does not intend to exclude business enterprises which are actually small business enterprises that manufacture an article or commodity which is not manufactured by any other business. The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of this Act if it is actually a small business enterprise." (Underscoring Supplied)

E. Electrolyte, the product here in question, is basically sulfuric acid and water. SIC 2819, Industrial Inorganic Chemicals, Not Elsewhere Classified, which includes sulfuric acid, lists in excess of 150 different products. Thus, it alone cannot be considered a "field of operation" for the purpose of establishing dominance. Moreover, the latest figures (1966) available show that aggregate sales of products in SIC 2819 were in excess of $3 billion. Sales from shipments of sulfuric acid for the same period were approximately $200 million. While Scholle concedes it distributes electrolyte nationally, there is no evidence to support a finding that it exercises a controlling influence in SIC 2819 industry; or that it has ownership or control of materials, processes, patents, license agreements and facilities. Based on the figures cited above, and assuming normal growth in the industry as a whole and the production of sulfuric acid in particular, Scholle and its affiliates would not be dominant, even if sulfuric acid were a separate field of operation.

F. For the foregoing reasons and since Scholle Atlanta Corporation and its affiliates has fewer than 1,000 employees, the Board finds that it is a small business concern for the purpose of this procurement.

Accordingly, the appeal is denied.

Decided: July 29, 1970

Einar Johnson, Chairman

Marshall Parker

Jack Bachon, Jr.

Wilfred J. Garvin

Adopted:

Hilary Sandoval Jr.

Hilary Sandoval, Jr.
Administrator

No. 453

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF KOPPERS COMPANY, INC.

The Size Appeals Board, having considered the appeal of Koppers Company, Inc., Pittsburgh, Pennsylvania, from the determination of the Boston Regional Office of the Small Business Administration that Selco U. S., Inc., Cambridge, Massachusetts, and Electronic Space Systems Corporation, Concord, Massachusetts, are small business concerns for purposes of bidding on and receiving award of a Government contract under Invitation for Bids No. DAAB07-70-B-0523, issued by United States Army Electronics Command, Fort Monmouth, New Jersey, finds that:

A. This procurement is a total set-aside for small business concerns and calls for the prospective contractor to furnish 5 each Space Frame Radomes, Essco Model M-68-70 or equal. Radomes are housings or enclosures for the protection of radiating devices (antenna) against the elements of environment. The contracting officer classified the product in Standard Industrial Classification Industry 3662, Radio and Television Transmitting, Signaling, and Detection Equipment and Apparatus. The applicable size standard for establishments in SIC Industry 3662 is average annual employment not exceeding 750 employees.

B. Koppers Company, Inc., protested the size eligibility of both Selco U. S., Inc. (Selco) and Electronic Space Systems Corporation (Essco) to participate in this procurement. Koppers, together with its affiliates, is a large concern and ineligible to submit a bid. It is contended that Selco and Essco are not small business concerns because they are both dominant in the field of manufacturin "rigid ground radomes 10 feet in diameter and larger." It is conceded that Selco and Essco otherwise qualify as small business concerns.

C. Section 121.3-2(r) of the Small Business Size Standards Regulation provides as follows:

> "A concern is 'not dominant in its field of operation' when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration shall be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity."

D. Information of record indicates that the concept of rigid radome types was developed by Lincoln Laboratory, Massachusetts Institute of Technology, in the 1950's. Prototypes of the dielectric space frame radome have been produced by Lunn Laminates, Huntington, New York, and Steiner Plastics, New York, N. Y. Koppers Company, Inc., is an experienced manufacturer of this type. The second type is the metal space frame radome and is the subject of this contract. Prototypes of this radome were produced by Atkins and Merrill, Marlboro, Massachusetts, and H. I. Thompson, Inc., Cardena, California. In addition to these concerns, other producers of radomes include Geonautics, Inc., Newburyport, Massachusetts; Goodyear Aerospace Corporation, Akron, Ohio; North American Rockwell Corporation, Columbus Division, Columbus, Ohio; Selco and Essco. A number of these concerns have contributed to the present state of the art.

E. Selco has submitted information showing that since its inception in April 1968, it has received a total of four contracts totaling less than $300,000. Essco's total sales for the preceding three fiscal years amounted to approximately $6.6 million. Information submitted by Essco, based on statistics taken from the 1967 Census of Manufactures, the latest data available of sales by SIC codes, shows that sales in Industry Code 3662 amounted to approximately $7 billion. On the basis of Essco sales of less than $3 million for each of the preceding three fiscal years, it would have significantly less than one percent of the market. Selco's share of the market would be even less. The average annual employment of Selco and Essco is 101 and 4 persons respectively.

F. Koppers Company, Inc., alleges that Selco and Essco are dominant in "the production of rigid ground radomes 10 feet in diameter and larger." This product is one of approximately 80 produced by SIC 3662 establishments. In this connection the Board has held that ". . . the question of dominance applies to a concern's position in a particular industry category and not with respect to one product or commodity, unless that product or commodity has a sufficient economic impact to be regarded as a separate industry." Size Appeal of Ames Industries, Inc., No. 398, December 15, 1969. Even if radome sales are reported in one of the following subcategories of SIC 3662, the share of the market enjoyed by either Selco or Essco would be insignificant.

Subcategory	Description	1967 Sales
3662400	Electronic navigational aids except missile-borne and space vehicle borne equipment	$1,077,600,000
3662500	Electronic search and detection apparatus including radar, infrared and sonar	1,638,300,000
3662600	Electronic military, industrial and commercial equipment N.E.C.	1,181,200,000

G. Finally, the Board notes that the solicitation calls for an Essco model "or equal." This means that the identification of brand name is intended to be descriptive but not restrictive. A bidder offering an "equal" product may be considered for award if such product is clearly identified in the bid and is determined by the procuring activity to be equal in all material respects to the brand name. This would appear to dispose of the contention of Koppers Company, Inc., that either of the protested concerns control patents, processes, materials, etc., sufficient to give them an unfair competitive advantage over other concerns.

H. Under these facts the Board finds that neither Selco nor Essco exercises a major or controlling influence on a national basis in SIC Industry 3662 as a whole or in the field of radome manufacture. They are not, therefore, dominant in their field of operation.

Accordingly, the appeal is denied.

Einar Johnson

Decided: October 7, 1970

Einar Johnson, Chairman

Clyde B. Bothmer

Adopted:

Jack Eachon, Jr.

Hilary Sandoval Jr.

Hilary Sandoval, Jr.
Administrator

Andrew A. Canell

Andrew A. Canellas

No. 398

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF AIMES INDUSTRIES, INC.

The Size Appeals Board, having considered the appeal of Aimes Industries, Inc., Lockport, Illinois, from the determination of the Small Business Administration's New York Area Office that Cine Products Supply Corporation, Gibbsboro, New Jersey, is a small business concern for award of a Government contract under Invitation for Bids No. F42600-70-B-0459, issued by Headquarters, Ogden Air Materiel Area, Hill Air Force Base, Utah, finds that:

A. This procurement is a partial set-aside for Motion Picture Sound Projection Sets in accordance with Military Specification MIL-[illegible].

B. Aimes Industries, Inc., contends that Cine Products Supply Corporation is not a small business concern due to its dominant position in the field of operation involved in this particular bid and because of its relationship with Viewlex, Inc.

C. A concern is a small business for this procurement if, together with its affiliates, its average annual employment for the preceding four (4) calendar quarters does not exceed 500 persons. With respect to dominance Section 121.3-2(r) of the Small Business Size Standards Regulation provides that:

> [illegible] concern is 'not dominant in its field of operation' when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration shall be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity."

D. The record indicates that Cine Products Supply Corporation is owned by Frank S. Dobbs who is its President and Treasurer. It has been a supplier of replacement parts for 16 MM motion picture equipment since 1949. Cine Products Supply Corporation is also a supplier of parts to Viewlex, Inc., and leases some of its tooling to Viewlex, Inc., for parts and material which Cine does not wish to supply. Aimes Industries, Inc., contends that Cine is the major producer of the 16 MM JAN projector as well as replacement parts; that it is [illegible] major supplier to the Government and other producers owns the tools used in the manufacture of replacement parts; and because of its dominant position in the field of 16 MM JAN projectors and parts is able to consistently underbid its competitors.

E. The record discloses that Cine Products Supply Corporation previously had two affiliates which are now inactive and their employees, if any, are included with those of the parent concern. As to its relationship with Viewlex, Inc., the evidence is insufficient to warrant the conclusion that either party controls or has the power to control the other.

F. According to Bureau of the Census data from the 1963 census, there were 495 companies which operated 538 establishments primarily engaged in Standard Industrial Classification (SIC) Industry No. 3861, Photographic Equipment and Supplies. The total value of all shipments of such equipment by these companies was $1,851,213,000. These companies accounted for [illegible] percent of the total value of shipments by all companies regardless of the industry in which their establishments were classified. Motion picture equipment consists of products within SIC Industry 3861. The total value of shipments of motion picture equipment for 1963 was [illegible],000. These shipments were made by 74 companies. Eleven (11) companies, having an average of 1,000 or more employees, accounted for 55 percent of the total shipments and seven (7) companies with [illegible] to 1,000 employees accounted for an additional twenty percent of the market. The remaining 25 percent was accounted for by 56 smaller companies which would include Cine Products Supply Corporation which employs an average of less than 100 persons.

G. While Cine Products Supply Corporation may be the major producer of the 16 MM JAN projectors and parts, there are many more products included in Industry 3861. The legislative interpretation of the word "dominance" as used in the Small Business Act and Regulations is found in the Report of the House Banking and Currency Committee (H.R. 494, 83rd Cong. 1st Session 5/26/53, p. 10) which states, in pertinent part, that ". . . With respect to nondominance in its field, the committee does not intend to exclude business enterprises which are actually small business enterprises that manufacture an article or commodity which is not manufactured by any other business. The mere fact that a small business makes a particular product or item is not intended to disqualify it from the benefits of this act if it is actually a small business enterprise."

H. The Board has consistently held that the question of dominance applies to a concern's position in a particular industry category and not with respect to one product or commodity, unless that product or commodity has a sufficient economic impact to be regarded as a separate industry. Since the manufacture of the 16 MM JAN projector and parts does not fall within this classification, the Board finds that Cine Products Supply Corporation is a small business concern for this procurement.

Accordingly, the appeal is denied.

Decided: December 15, 1969

W D Brewer
W. D. Brewer, Chairman

Adopted:

James L Mills
James L. Mills

Hilary Sandoval Jr.
Hilary Sandoval, Jr.

Anthony S. Stasio
Anthony S. Stasio

W. J. Garvin
Wilfred J. Garvin

BEFORE THE

SMALL BUSINESS ADMINISTRATION

SIZE APPEALS BOARD

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF SUNROC CORP.

(Re: Elkay Manufacturing Co.)

The Size Appeals Board, having considered the appeal of Sunroc Corp. (Sunroc) from the January 15, 1976, decision of the Chicago District Office of the Small Business Administration that Elkay Manufacturing Co. (Elkay) is an eligible small business concern within the 750 employee size standard applicable for a procurement of water cooler dispensers set-aside by the General Services Administration for bidding by small business concerns, finds that:

A. The questions presented by this appeal are:

(1) Is Elkay dominant in its field of operation and thus not small under the SBA Regulations?

(2) Did Elkay's acquisition in December 1975 of certain assets, a plant and its employees constitute acquisition of an affiliate?

(3) If not an affiliate, must such employees still be considered as Elkay employees for the entire applicable accounting period in computing Elkay size?

B. Pertinent SBA Regulations and precedents applicable to this case include:

Section 121.3-8 - Dominance in the field of operation in which bidding is a disqualifying factor.

Section 121.3-2(s) - Controlling or major influence in the field of operation on a national basis is dominance. All pertinent factors are considered in determining dominance, including competitive position and resources.

Section 121.3-2(i) - "Concern" means any business entity organized for profit. It includes but is not limited to individuals, partnerships, corporations, joint ventures, associations and cooperatives.

Section 121.3-2(a) - "Affiliates" are concerns under common control.

Section 121.3-2(t) - "Numb[illegible] employees" means the average empl[illegible] a concern," including its a[illegible]es, based on the num[illegible] of persons [illegible] at the pay period at the e[illegible]ch of the four p[illegible] calendar q[illegible] Employees [illegible]filiates a[illegible] during the appl[illegible]eriod are c[illegible] the entire [illegible], not jus[illegible]od du[illegible] computation provisions of this regulation have been changed to now require averaging of employment during each pay period in the year, but this change is not applicable to the present procurement 41 F.R. 9297, March 4, 1976.)

Digest of Decisions of the Size Appeals Board VII-D-1, Appeal #453, 10-7-70

Dominance applies to the industry SIC unless a product has a sufficient economic impact to be regarded as a separate industry.

Digest of Decisions of the Size Appeals Board VIII D-2, Appeal #458, 12-3-70

Where purchase of all the tangible and intangible personal property used for manufacture and sale of a named line of products, and no stock purchase or assumption of liabilities, the Board held that it was an acquisition of assets only and not of a going concern, and employees of the acquired operation need be included only from the date of acquisition and not for the entire year.

C. The SBA field office found that Elkay was not dominant within SIC 3585, Air Conditioning and Warm Air Heating Equipment and Commercial and Industrial Refrigeration Equipment, the category containing the water cooler dispensers being procured. It also found that Elkay had less than 750 employees, and included the employees acquired in December 1975 only for the last quarter and not for the entire year. If the acquired employees are included for the entire year it would bring Elkay over the applicable 750 employee size standard.

The acquisition in December 1975 was from Eaton Corporation (Eaton) and consisted of water cooler operations located at Lanark, Illinois. The assets acquired included a plant and its land, inventory and production machinery and equipment, trademarks, certain manufacturing know-how, and production and customer records. Ninety-three (93) employees were acquired.

Subsequent to such acquisition GSA asked for a new size determination on Elkay which is the one being appealed. The SBA office had made a previous determination also finding Elkay to be small.

D. Sunroc argues that Elkay already had a substantial portion of the water cooler market and that its acquisition of the Eaton water cooler facilities and customers increased its portion. It also argues that Elkay supplies sink components to other water cooler manufacturers and thus is in a position to further influence or control the water cooler industry.

Elkay submits information indicating that a number of other companies, including Sunroc have greater water cooler sales than Elkay and that several of these are subsidiaries of big business. It indicates that the water cooler market is approximately $61 million and that its sales (including those of the Eaton acquisition) in 1975 were approximately less than 20 percent of this amount. It indicates that its sales of sink components to competitor water cooler manufacturers did not exceed $200,000 in 1975 and that other sources are available of such sink components. It states that under SBA precedents the entire SIC 3585 is the area for determining dominance and that it is not dominant in either SIC 3585 or the water cooler area. The Board finds that Elkay is not dominant in the pertinent SIC 3585.

E. Sunroc argues that by purchasing an integrated productive entity (i.e., Eaton's water cooler plant, machinery, trademarks, customers and employees) Elkay has, in effect, purchased an affiliate. Sunroc states that Elkay's position is no different than if such had been purchased in corporate form and that it would be contrary to the purposes of the Small Business Act and to the general Board approach of viewing substance not form to consider this other than the acquisition of an affiliate. Sunroc notes that if the Eaton acquisition is determined to be of an affiliate the regulations require the acquired employees to be included for the entire year, which would put Elkay over the size standard.

Elkay states that it purchased certain selected assets of Eaton which merely constituted an Eaton sub-division and product line. It also notes that Board precedents indicate that an acquisition of assets not being in the form of a business entity has not been considered to be acquisition of an affiliate. It indicates that it did not purchase other machinery and product lines which had also been in the plant and that the employees acquired were mostly production hourly employees, not management personnel. Elkay argues that since the Eaton water cooler assets were not a "business concern" it did not constitute acquisition of an affiliated concern. The Board finds that the purchase did not constitute a "business entity" or "business concern under Section 121.3-2(i) and was therefore not the acquisition of an affiliate.

F. Sunroc argues that now that it is clear (and Elkay admits) that Elkay has more than 750 employees it would be contrary to the purpose of the Act to allow award of the contract to a firm which exceeds 750 employees. It notes that the SBA regulations state a policy that firms which have grown beyond the size standard should not seek to retain special small business status. It argues that to apply the averaging regulation in such case as this is illegal.

The Board finds that the regulation is clear on its face (Section 121.3-2(t)) and requires averaging of the firm's employment during pay periods at the end of each quarter of the preceding year. Board precedents have applied the regulation in such manner. The Board has no authority to find a Part 121 regulation legally invalid but merely applies the regulations to cases before it. In any case, Elkay might reduce certain employment over the upcoming months and thus stay within the 750 average, and only have a present temporary peak over 750 employees. The Board believes the regulation constitutes a reasonable exercise of SBA's discretion in averaging employment over the pertinent period for determining size status, and that SBA can use average employment rather than employment on a particular day in determining size.

F. The subject appeal is therefore denied and the decision of the Chicago District Office is affirmed.

Date decided: March 10, 1976

Harold K Fletcher

Harold K. Fletcher, Acting Chairman
Size Appeals Board

Members of the Board present
and voting:

Alice Cullen
Robert McDermott
Arthur Haubold
Arthur Glick

232

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF SPECIALIZED PRINTED FORMS, INC.

(Re Keith Clark, Inc.)

The Size Appeals Board, having considered the appeal of Specialized Printed Forms, Inc. (SPF), Caledonia, N. Y., from the March 11, 1975, determination of the Regional Office of the Small Business Administration, New York, N. Y., which held that Keith Clark, Inc. (KC), New York, N. Y., is a small business concern within the 500 employee size standard, finds that:

A. This solicitation (IFB-FPOO-EV-80342-A) was issued by the Federal Supply Service, General Services Administration, New York, N. Y., and is a procurement of refills, appointment book for calendar year 1976. This procurement is one hundred (100) percent set-aside for small business. The Contracting Officer specified the applicable small business size standard as 500 employees. SPF protested the size eligibility of KC on the basis of allegations of more than 500 employees of KC and its affiliates and on the basis of KC dominance in its field of operations. The SBA New York Regional Office found that KC and its affiliates have less than 500 employees and that KC is not dominant in its field of operation, which the Regional Office found to be Standard Industrial Classification (SIC) 2752, Commercial Printing, Lithograph.

B. Applicable provisions and precedents include the following:

Section 3 of the Small Business Act (15 U.S.C. 632) provides:

> "For the purposes of this Act, a small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria, the Administrator, in making a detailed definition, may use these criteria, among others: Number of employees . . . ."

Section 121.3-8 of the SBA Regulations (13 C.F.R. 121.3-8) provides:

> "A small business concern for the purpose of procurement is a concern, including its affiliates, which is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts and can further qualify under the criteria set forth in this section . . . .
>
> * * * * *
>
> "(b) Manufacturing. Any concern bidding on a contract for a product it manufactured is classified:
>
> * * * * *

> "(3) As a small concern if it is bidding on a contract for a product classified within an industry not set forth in Schedule B of this part and its number of employes does not exceed 500 persons . . . . (It is undisputed that the subject procurement is not within an industry set forth in Schedule B and is therefore subject to the 500 employee size standard.)"

Section 121. 3-2 of the SBA Regulations (13 C. F. R. 121. 3-2) provides:

> " (a) Affiliates: Concerns . . . are affiliates of each other when either directly or indirectly (1) one controls or has the power to control the other, or (2) a third party or parties controls or has the power to control both . . . .
>
> . . . . .
>
> "(s) A concern is 'not dominant in its field of operation' when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged . . . .
>
> "(t) 'Number of employees' means the average employment of any concern, including the employees of its domestic and foreign affiliates, based on the number of persons employed on a full-time, part-time, temporary, or other basis during the pay period ending nearest the last day of the third month in each calendar quarter for the preceding four quarters . . . ."

In the Size Appeal Board case of Teca Corporation (Appeal No. 631; September 7, 1973) it was stated that the Board has previously held that:

> ". . . the question of dominance applies to a concern's position in a particular industry category and not with respect to one product or commodity, unless that product or commodity has a sufficient economic impact to be regarded as a separate industry'" [See Size Appeal of Aimes Industries, Inc. (DDSAB at VII-A), December 15, 1969].

In reaching this holding we reviewed the legislative history of the Small Business Act which reveals that Congress did consider the question of dominance in the manufacture of a particular product, as distinguished from dominance in the industry. It stated:

> ". . . With respect to nondominance in its field, the Committee does not intend to exclude business enterprises which are actually small business enterprises that manufacture an article or commodity which is not manufactured by any other business. The mere fact that a small business makes a particular product or item and is dominant in its field with respect to the particular product or item is not intended to disqualify it from the benefits of this Act if it is actually a small business enterprise" [See Report of the House Banking and Currency Committee (H. R. 494, 83rd Cong., 1st Session 5/28/53, p. 10)].

The Board has subsequently stated that dominance must be established with respect to all activities or products included within the SIC applicable to the procurement and is not limited to the particular products or services involved in the procurement [Size Appeal of American Battery Acid Corporation (DDSAB at VII-A), July 29, 1970]; [Size Appeal of Sominers Building Company (DDSAB at VII-D), September 22, 1970]; and [Size Appeal of Control Laser - Orlando, Inc. (DDSAB at VII-A), August 18, 1971].

Since E[illegible] failed to submit sufficient evidence to show that the procured item has a [illegible]ent economic impact in order to consider it as a separate industry, [illegible] dominance must be established with respect to all activities or product[illegible] [illegible]uded in SIC No. 369[illegible]. . . ."

C. The na[illegible] of the item being procured is important with respect to the questions [illegible] by this appeal. The IFB requires that "the refill shall be designed f[illegible] six (6) ring loose-leaf binder, 1 inch capacity, FSN 7510-285-1765. The [illegible] size shall be 6-1/2 inches long by 5-1/2 inches wide . . . . There shal[illegible] page for each day of the year. . . . Following each Saturday sh[illegible] ne a page, colored for easy identification, which shall list each day of [illegible] coming week, with a space for notes for each. These weekly pag[illegible] shall extend above or to the side of the daily pages approximately 1/4 [illegible], or otherwise indexed to permit easy location, and shall show [illegible] date of the week beginning . . . . There shall also be sufficient p[illegible] to provide a double page spread for each month of the year, with [illegible] pace for notes for each day of the month."

The General Services Administration Supply Catalog lists the binder for FSN 7510-2[illegible]765 as a "Planning and appointment guide. Binder for use with Calend[illegible] and Appointment Record refills . . . 6-ring. Black plastic cover."

The Board [illegible] this refill planning and appointment book item thus [illegible] within SIC [illegible] Manufacturing - Establishments primarily engaged [illegible] manufactur[illegible] [illegible]kbooks, loose-leaf devices, and library binders [illegible] in ruling pa[illegible] This SIC includes [illegible] calendars and refills, diari[illegible] and printe[illegible] [illegible]ndum [illegible], as well as albums, account books, [illegible] paper and receipt books. Based upon the submissions in the record, it appears that there is no disagreement that SIC 2782 is the appropriate SIC Code with respect to the procurement involved in this case. It therefore appears that the Regional Office was incorrect in using SIC 2752 (Commercial Printing, Lithograph) in its determination. However, as indicated below the Board does not find KC to be dominant within its appropriate "field of operation", and SPF does not contend that KC is dominant as to either SIC 2752 or SIC 2782.

D. KC has submitted specific information to SBA on its payroll and number of employees. Such information has been certified by its President as true and complete, noting his awareness of the criminal penalties for false statements, with affirmation that KC and its Puerto Rico subsidiary have a total average number of employees for the preceding four quarters of 424 employees. KC has offered to make its complete payroll records available for SBA investigation. KC specifically states that at no time during 1974 did it and its subsidiary's combined employment exceed 500 persons. KC further states that it has no affiliates other than its wholly owned Puerto Rico subsidiary, and that SPF allegations of other KC affiliates are incorrect since the other concerns alleged as affiliates are manufacturers agents which sell KC products but are not in any way under KC control.

SPF has submitted no specific information or data to rebut this KC information, but has estimated that KC employment exceeds 500 employees and has assumed that firms listed in telephone book advertisements as distributing KC products are under KC control and therefore are affiliates.

The Board finds that KC and its Puerto Rico subsidiary (affiliate) have total combined average annual employment not exceeding 500 persons. The Board does not find that KC has any other affiliates. Accordingly, the Board affirms the findings of the SBA New York Regional Office that KC and its affiliates are within the 500 employee size standard for this procurement.

E. With respect to the issue of dominance, the Board notes that SPF does not contend that KC is dominant as to the pertinent SIC 2782, which as indicated above includes desk calendars, refills, appointment books and similar items. SPF argues that the item being procured is a desk calendar refill and that desk calendars are not interchangeable with planning-appointment books. It does not contend that KC is dominant as to planning-appointment book items, but argues that KC is dominant as to desk calendars and refills. However, as set forth above, the item being procured here also has aspects other than a desk calendar refill. It is largely a planning guide designed for insertion into a small loose-leaf book and is not limited to desk use.

Based upon the specific item being procured here and the above quoted legislative history of the Small Business Act and Board precedents, the Board believes it should view the "field of operation" for consideration of possible KC dominance as being SIC 2782, or arguably the field of combined planning-calendar items. There has been no evidence submitted and SPF does not argue to the effect that KC would be dominant within either of these "fields of operation". The Board does not view the narrow category of desk calendars and/or their refills as an appropriate "field of operation" in this case for purposes of considering possible dominance under section 3 of the Small Business Act. As indicated by the House Report quoted above, the Congress did not intend that possible dominance with respect to particular products or items be "dominance" disqualifying a firm as a small business concern for purposes of the Small Business Act.

Therefore, since we do not agree with the SPF contention that the desk calendar/refill category is an appropriate "field of operation" for determining possible "dominance" under section 3 of the Small Business Act, the Board finds it unnecessary to consider the SPF arguments that KC is the dominant firm within this category. This is the only type of KC dominance that is alleged by SPF.

Accordingly, the Board finds that KC is not "dominant within its field of operation" under section 3 of the Small Business Act and is an eligible small business concern.

F. The Board finds that it is unnecessary to hold an oral hearing and the SPF request for an oral hearing is denied.

Accordingly, the appeal of SPF is hereby denied and the Board affirms the findings of the SBA New York Regional Office that KC is an eligible small business concern within the applicable 500 employee size standard and not dominant in its field of operation under the Small Business Act.

Date decided: May 2, 1975

Louis F. Laun, Chairman
Size Appeals Board

Members Present and Voting: Robert F. McDermott
Bernard Kulik
Arthur E. Armstrong
[illegible] K. [illegible]

No. 986

BEFORE THE

SMALL BUSINESS ADMINISTRATION

SIZE APPEALS BOARD

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF NETTER INTERNATIONAL, INC.

The Size Appeals Board has considered the appeal of Netter International, Inc. (Netter), from a determination of the New York Regional Office that Netter is other than small for the purpose of assistance by small business investment companies. The Board finds and concludes as follows:

FINDINGS AND CONCLUSIONS

CMNY Capital Corporation, an SBIC, invested in Netter, a reinsurance firm, on January 11, 1974. Initially, the investment was determined to be a violation of Section 107.1001(a) of the SBA Regulations on reinvesting. Subsequently, by letter dated December 15, 1975, SBA concluded that the Netter financing was not a violation of Section 107.1001(a). However, it asserted that Netter might present a size problem, and suggested submission of a size application.

Netter submitted an application. By letter dated January [illegible] 1976, the New York Regional Office determined that Netter was other than small under the financial criteria set forth in Sections 121.3-10 and 121.3-11. By letter dated December [illegible], 197[illegible], almost a year later, Netter filed an appeal.

Netter contends that it is not dominant in its industry and that it is the second smallest entity in its industry. Thus, it contends that it should be a small business concern eligible for assistance from an SBIC.

The Board concludes that dominance is only one of the criteria in the size standards set forth in Section 121.3-11 and 121.3-10. There are also specific criteria in terms of financial figures. Netter does not dispute that it does not meet these criteria.

In view of the foregoing, the Board denies the appeal of Netter International, Inc., and affirms the determination of the New York Regional Office that Netter is other than small for the purpose of assistance by small business investment companies.

Date decided: February 1, 1977

Harold K Fletcher

Harold K. Fletcher, Acting Chairman
Size Appeals Board

Members of the Board present
and voting:

Robert F. McDermott
Arthur E. Armstrong
Alice K. Cullen
Geraldine H. Porter

No. 1378

BEFORE THE

SMALL BUSINESS ADMINISTRATION

SIZE APPEALS BOARD

FINDINGS AND DECISION OF THE SIZE APPEALS BOARD IN THE MATTER OF SIZE APPEAL OF LAUHOFF GRAIN CO.
(Re: Krause Milling Company)

The Board has considered the appeal of Lauhoff Grain Company (Lauhoff) from a determination of the Chicago Regional Office that Krause Milling Company (Krause) is a small concern and not dominant. The Board finds and concludes as follows.

BACKGROUND

The Department of Agriculture solicited bids for supply of various grains. Part of the solicitation requested bids for soya fortified corn meal. The solicitation was pursuant to Pub. L. 480, the Food for Peace Program. Under the terms of the solicitation, up to 10 percent of the quantity desired could be awarded to a small business concern if the contracting officer determined that the bid price was not too high.

Lauhoff, a large concern, and Krause, a concern certifying itself as small, bid on the solicitation. Lauhoff protested the size status of Krause on the ground that it was dominant in the field of operation.

The protest was referred to the Chicago Regional Office. That office found that Krause met the size standard, and that it was not dominant.

Lauhoff appealed.

The procurement here involved is for soya fortified corn meal. It is 85 percent corn meal. Corn meal is classified in Standard Industrial Classification (SIC) 2041 "Flour and Other Grain Mill Products." This has a size standard that the number of employees not exceed 500. Krause has less than 500 employees. However, Lauhoff contends that the regulations also require that Krause not be dominant in the field of operation in which it is bidding on government contracts. Lauhoff admits that Krause is not dominant in the industry defined by SIC 2041. However, it contends that the field of operations should be defined more narrowly than SIC 2041 to cover only dry corn milling for resale. It also contends that Krause is dominant in that field of operation.

SIC 2041 covers establishments primarily engaged in milling flour or meal from grain, except rice. Some of the kinds of grains mentioned are buckwheat, corn, rye, and wheat.

ISSUE

Should the field of operation be defined more narrowly than SIC 2041 to cover dry corn milling or dry corn milling for resale?

Relevant Regulations and Precedents

13 CFR § 121.3-8 Definition of small business for Government procurement.

> "A small business concern for the purpose of Government procurement is a concern, including its affiliates, which is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts and can further qualify under the criteria set forth in this section. . . ."

Dominance must be established with regard to the SIC industry applicable to the product procured and not limited to the particular product procured, unless there is a showing that the more specific industry definition claimed for the product procured has sufficient economic impact to be regarded as a separate industry. DDSAB VII-D-1 Appeal #431, 7-29-70, Appeal #449, 9-2[illegible]; DDSAB VII-A-2, Appeal #398, 12-15-69, Appeal #769, 7-2[illegible], Appeal #1101, 11-22-77, Appeal #1135, 2-10-78.

Lauhoff's Contentions

Lauhoff contends as follows: The field of operations should not be considered SIC 2041, but should be further limited to dry corn milling for resale. Wheat and corn milling products are not readily fungible because of difference in chemical and physical properties, and consumer taste. Equipment for milling operations for grain other than corn cannot be readily converted for use in dry milling of corn without substantial expense; thus, other dry grain millers are not likely entrants into the dry corn milling field. The vertically integrated dry corn millers rarely sell on the open market such as on the procurement involved; thus, the dry corn milling industry should be defined to include only those that produce for resale.

Krau[illegible] Response

Krau[illegible] responded to the Lauhoff contentions as follows: Wheat and corn dry milling products do have fungibility in terms of end use based on price. Dry milling operations for wheat and corn are similar. A number of industry giants do both corn and wheat milling, because of the similar technical, managerial, and plant requirements. A dry milling operation for wheat or other grain can be converted to corn without change of plant or personnel. The processes are similar and there is need to modify only some of the equipment, primarily to accommodate the difference in the size of grains. Corn millers not operating primarily in the resale market cannot be excluded in defining the relevant market because they may enter the resale market if economic conditions warrant.

CONCLUSIONS

Lauhoff has contended that there are distinctions between milling of corn and other grains such that dry corn milling for resale should be considered a separate field of operation. SBA generally uses the SIC definition of an industry in establishing the size standard, the basic measure of size. The Board has held that the proponent of a special definition for field of operation must show that such definition has sufficient economic impact to be regarded as a separate industry. This Lauhoff has not done.

We have obtained data from the 1977 Census of Manufacturers issued by the Bureau of the Census. This is the latest edition available. It indicates a special five digit classification, 20413, for corn mill products. There is no subdefinition for corn mill products for resale. The value of all shipments in SIC 2041 in 1977 was $3,678.6 million, and the value of all shipments in SIC 20413 was $413.3 or only 11.2 percent. It does not appear that this is of sufficient significance to warrant a definition of field of operation for corn mill products smaller than SIC 2041, such as SIC 20413.

Since we have concluded that there is no basis for a special definition of field of operation smaller than SIC 2041, we do not need to reach the issued argued by the parties as to whether Krause is dominant in a smaller field of operation.

Krause has provided figures on its sales of corn products in 1977. These show that its sales as a percentage of the $3,678.6 million of sales in SIC 2041 are a very small percentage. Indeed, Lauhoff admits that Krause is not dominant in SIC 2041.

Accordingly, we conclude that Krause is not dominant in SIC 2041.

In view of the foregoing, the appeal of Lauhoff is denied, and the Board determines that Krause is a small business under the size standard that the number of employees not exceed 500, that the field of operation should not be defined more narrowly than SIC 2041, "Flour and Other Grain Mill Products," and that Krause is not dominant in SIC 2041.

Date decided: September 19, 1980

Bernard Kulik
Vice Chairperson
Size Appeals Board

Members of the Board present and voting:

Charles Hertzberg
Rodney Lewis
Robert McDermott
John Whitmore

Mr. SKELTON. Are there other questions, Mr. Orban?

Mr. ORBAN. Let me ask one question. We heard from WATS resellers that in changing their access rules in your docket No. 86-1, to eliminate combined access charge, that it dramatically increased the access costs for these resale carriers.

Did you do any kind of analysis on that? Did you make any kind of allowance for the effect it would have on these WATS resellers, and, if not, why not?

Mr. FOWLER. Let me ask Mr. Halprin, who is the chief of our Common Carrier Bureau to address that.

Mr. HALPRIN. Yes, sir; we did do a very careful analysis over a period of probably 4 years concerning the changes in treatment of WATS.

In fact, as a result of the FCC's changes, prices on WATS service, including the prices that are charged to the resellers, will be dropping dramatically on June 1, in fact, dropping by over 15 percent during the day and evening when most of it is used.

We—the Commission believes very, very strongly that the changes that it has made will strongly serve the public, will serve small business in the United States, and will result in an increase of availability of quality low-priced telephone service.

Mr. ORBAN. Did you put it in a Regulatory Flexibility analysis?

Mr. HALPRIN. No, sir.

Mr. ORBAN. Why not?

Mr. HALPRIN. The WATS resellers, in this case, are treated identically to every other customer of WATS service. They are nothing but a customer. We do not regulate them in any way whatsoever.

As a result of Commission decisions, we impose no regulatory burdens on these companies whatsoever. Customers are not cognizable, in our understanding, of the law under the Small Business Act.

In fact, there are tens and tens of thousands, if not hundreds of thousands of small businesses who are WATS customers, a small percentage of whom take that service and then resell it to others—residential or small business customers.

And we were very cognizant of the public interest involved in providing quality low-cost service to those customers. That was a central focus of the docket, but every single tariff that is on file, directly or indirectly, affects small business.

Mr. ORBAN. I think that is what we are getting at. You are drawing a distinction here to say that if it indirectly affects small business, then in your view you don't have to do a regulatory flexibility analysis, only where it directly affects small business, under your regulations, is that not correct?

Mr. HALPRIN. Yes, sir; every service that is offered by a telephone company is utilized by small businesses, and our understanding of the Regulatory Flexibility Act is that we are, we should not be analyzing every tariff filing, every regulation in terms of the impact on the customers of the companies whom we regulate.

Mr. ORBAN. On what specifically do you have any hard document on which you base that determination?

Mr. FOWLER. I would like to interject that there is a case decided in the DC Court of Appeals in the fall of 1985, which holds that an agency may properly certify that no regulatory flexibility analysis is necessary when it determines that the rule will not have a significant economic impact on a substantial number of small entities that are subject to the requirements of the rule.

It dealt with the question of whether or not the agency had to take into account the indirect impacts of a proposed regulation.

Mr. ORBAN. So, that is the basis of your decision then?

Mr. FOWLER. Yes.

Mr. ORBAN. And we don't need to go into it?

Mr. FOWLER. In fact, everything that we do, if you think about it, would have all kinds of effects on society, on an indirect basis—for businesses, in terms of the number of people that they employed perhaps—in the number of telephones that they bought.

If we had to do that kind of an analysis, I imagine we would probably have the largest bureaucracy in the world. I do not even think it would be possible to do.

Mr. ORBAN. Obviously, though, there is going to be a line drawn someplace as you tier out to those people who have indirect effects. You have chosen to draw the line at the first tier, the very first group that has been regulated?

Mr. HALPRIN. Yes, sir; the second tier does include all costomers for every rate filed by every telephone company and every long-distance carrier. They are all customers who are purchasing that.

And I point out, in addition to the size of the bureaucracy, pursuant to the chairman's directive, and the Commission's directive, we have been expediting our procedures reducing regulations, and we have been able to see substantial rate decreases brought to the American public.

A delay in our procedures would only have the effect of delaying the types of rate decreases that we have seen and the mammoth rate decreases that will be seen within a couple of weeks.

Mr. ORBAN. Thank you, Mr. Chairman.

Mr. SKELTON. Mr. Chairman, the gentleman from Florida, Mr. Ireland, who had to leave, asked the question of witnesses earlier, witnesses who felt that they were not getting a fair and open ear, particularly telephone groups that testified.

Were they dealing with lower level parts of the bureaucracy or whether it was emanating from and being communicated to and from the very top, such as you?

And the indication was that in most instances it was not emanating to the top.

We are at the top now, and I understand that we have your attention and your interest, and I appreciate your courtesy in being here so very much.

There are alternatives, of course, with people who would disagree. One, of course, is to go to court; and the other is to put more teeth into the Regulatory Flexibility Law, one of which would be to allow judicial review, and all that goes with that.

We would hope that the agencies would do their best to comply as opposed to having to change the law.

That was the purpose of this hearing, to see what other problems, or what answers can be brought to solve them; and we will, of course, be advised as to the various agencies, how they go from here.

It is interesting; we are getting some agencies that are doing an extremely fine job, some that are not doing a fine job; and some where there is a mixed bag.

In some of your comments, obviously, you are following it, and in other areas, we would like you to take a good closer look at it, and see if we could not read the law a little more in its spirit and intent.

Mr. **Fowler**. Well, I certainly agree, Chairman Skelton, that with small telephone companies which generally are very small businesses, even though they do not come under our reading of the Regulatory Flexibility Act, we should be very sensitive to the kinds of regulations we impose. We should make sure that if we do have to regulate, we do it in the least regulatory way possible.

I know that there are some phone companies that are very small entities, of 6 or 10 people, and so I think this hearing has been very good for me, because it sensitizes me even more than I had been before to think about that when we promulgate these rules.

Mr. **Skelton**. One of the witnesses representing one of the telephone companies had, I think, a total of 750 customers.

Mr. **Fowler**. Yes, sir.

Mr. **Skelton**. But there is a serious problem there, and we would urge you to take a close look at it.

Yes.

Mr. **Orban**. Could I have one more question for the record?

Mr. **Skelton**. Yes.

Mr. **Orban**. In your statement, you mentioned the carrying out of the two policy objectives. One was the promotion of the free marketplace competition. Let me bring you back to the satellite rulemaking case that was mentioned earlier in testimony by the small business advocate where she mentioned that after 21 applicants had applied for a satellite service, a limit was placed of $300 million on the amount of money that a business had to have to be able to qualify under this rulemaking.

Then it was certified that there was no impact on small business, because, obviously, a small business would not have the $300 million to qualify to apply.

Isn't that bootstrapping your way into certification? Do you think that fulfills your requirements to comply with the Regulatory Flexibility Act?

Mr. **Fowler**. Well, when you are dealing with satellites, you are dealing with something that is a very expensive item.

Typically, $200 to $300 million is required to be able to launch one of these birds.

Mr. **Orban**. Does that not foreclose someone from preselling services and being able to come up with financing?

Mr. **Fowler**. No; it clearly does not. It does not preclude any entity, even an individual, much less a small business from being able to put together a joint venture with a larger entity, or to get sufficient investors that he would be able to finance a $300 million proposition.

Mr. **Orban**. Do you do any——

Mr. **Fowler**. It does not depend on the size of the entity.

Mr. **Orban**. Did you do any analysis to determine that that would not preclude those people from getting into the business?

Mr. **Fowler**. Do you want me to answer that specifically?

I just wanted to say one thing—that there is an important public interest involved here. By requiring a financial ability showing, we are more nearly able to satisfy our goal of getting these satellites up so that service is provided to the American people more quickly than would be the case if we did not have financial requirements.

And so that is a very important requirement that we have; it's regulatory, admittedly. I don't think it eliminates any entity, though, from being able to apply; and they have plenty of notice. People do have the time to be able to come up with the requisite financing before filing these applications.

Mr. **Orban**. Well, but if it is known through your rule that a license applicant must have $300 million to begin with and if they haven't got $300 million, and if they can't get it by preselling, then where can a small business get the $300 million to qualify to file for the license under the rules?

Mr. **Fowler**. The answer is that if they can't provide the requisite financial showing, they will not be qualified.

And if they can go ahead and file an application, we will find it deficient, and will deny it.

Mr. **Orban**. But then, every small business who has a method of preselling satellite time is excluded?

Mr. **Fowler**. No; I don't think that is correct.

Mr. **Orban**. Aren't 10 of the 21 who originally applied, excluded by this rule?

Or didn't they withdraw or have to dramatically change their application?

Mr. **Fowler**. Some did not. We tried an experiment at one time. We said we will go ahead and be much more flexible on the kind of financial showing that we require of people proposing to loft these satellites.

Mr. **Orban**. Yes.

Mr. **Fowler**. Because it is in our interest to let as many people as possible come in and have as many satellites as possible up.

And it may be that once they have the authorization from the FCC to move forward, that might enable them to complete their financing.

What happened was something quite different. They were not, in many cases, able to complete their financing.

We then had to double back and open these slots up again, having found that they were not financially qualified, to other applicants. We delayed implementation of new satellite services as a result.

So, that was an experiment clearly which we tried—I am glad we did; it told us a lot; and it told us that we cannot expect tc get these satellites up as quickly as possible if we don't have a conventional financial showing. The public interest overall requires that showing to speed up the availability of service.

Mr. **Orban**. Do you have any record of that experiment that you just described?

Mr. **Fowler**. Yes, indeed; and we would be delighted to supply you with chapter and verse on that.

[The records of experiment referred to are in subcommittee files.]

Mr. **Orban**. Good.

Mr. FOWLER. Sure.

Mr. HALPRIN. If I could, just on that point.

Not only has the Commission gone out of its way to encourage new entrants to get into this field through its transponder sales policy, but, in fact, the Commission modified its original proposal so that in order to show financial qualifications, you actually did not have to go out and pay points to a bank to hold the money.

Obviously, that would have, in fact, been burdensome to small businesses. Any entrepreneur, any small business, who can go out and convince a financial organization that they have a good enough sales plan so that they can get a binding commitment to finance it, does qualify.

And we did modify our requirements to eliminate the need to actually hold the money, which would have required the payment of points during the entire process, to make it easier for new entrants and for entrepreneurs to get into this field.

Mr. SKELTON. Thank you so much.

Chairman Fowler, we appreciate your being with us. Thank you.

Mr. FOWLER. Thank you, Mr. Chairman.

Thank you, Mr. Coble.

Mr. SKELTON. Our last witness is James C. Handley, the Administrator of the Agricultural Marketing Service, U.S. Department of Agriculture—Mr. Handley.

And would you be kind enough to introduce the gentleman with you?

Mr. HANDLEY. Yes; this is John Golden from the general counsel's office.

Mr. SKELTON. Golden?

Mr. HANDLEY. Yes; sir.

Mr. SKELTON. Mr. Handley, please proceed.

Mr. HANDLEY. Thank you.

TESTIMONY OF JAMES C. HANDLEY, ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY JOHN GOLDEN, OFFICE OF GENERAL COUNSEL

Mr. HANDLEY. Mr. Chairman and members of the subcommittee.

I appreciate the opportunity to appear before your subcommittee to discuss the implementation of the Regulatory Flexibility Act [RFA] as it applies to the Agricultural Marketing Agreement Act of 1937, commonly referred to as the AMAA.

Accompanying me today, as I mentioned, is John Golden from the office of the general counsel, at USDA.

In testimony before your subcommittee on April 16, Assistant Secretary John Franke described activities of the Department in its implementation of the Regulatory Flexibility Act and addressed briefly procedures utilized by the Department for encouraging participation of small entities in marketing agreement and order rulemaking proceedings.

I will further discuss efforts of the Department and the Agricultural Marketing Service to comply with the Regulatory Flexibility Act and address concerns raised previously by the Small Business

Administration, as well as private individuals appearing before your subcommittee.

Mr. Chairman, before focusing on our procedures as they relate to the AMAA specifically, I wish to provide a bit of perspective and note that the Agricultural Marketing Service is responsible for the administration of programs emanating from 35 statutes. The agency's broad objective is to help foster an efficient, fair, and economical marketing system for agricultural products. Our main mission is service and we are principally user fee funded.

Many of AMS' activities require rulemaking and are subject to the RFA. For example, when proposals regarding fees for agricultural commodity grading services appear in the Federal Register, such proposals have had RFA consideration. Actions regarding the establishment or change of food standards also receive RFA consideration. Thus, our awareness and attention to the RFA is by no means one-dimensional.

This administration has demonstrated a concern for certain aspects of some marketing orders which originate from the AMAA, particularly those with features that may impede free enterprise. We have addressed these concerns elsewhere and will continue that thrust.

Our focus today is to address the issues of openness, fairness, and equity in the regulatory process associated with that authority.

We believe that AMS has a record of openness in the conduct of its programs, including those originating from the Agricultural Marketing Agreement Act.

In particular, the procedure for developing and implementing Federal marketing orders includes a rigorous sequence of public participation.

I think it would be helpful to the committee for me to briefly review that process.

First, marketing orders are originated by the industry affected. To my knowledge, none has ever been proposed by USDA. The formal rulemaking process begins when a written proposal is submitted to USDA by industry proponents with a request for a public hearing. If the proposal appears to merit further consideration, we typically issue a press release or notice inviting additional comments or proposals.

Subsequently, a notice is published in the Federal Register announcing a public hearing. The issues of what will be considered at the hearing are established by the hearing notice. The notice states each specific proposal to be considered. This is done to provide an opportunity for all parties to attend the hearing and testify on each proposal under consideration in which they have an interest. Testimony is not permitted on issues beyond the scope of those contained in the hearing notice. At the hearing, which is conducted by an administrative law judge, all witnesses, whether proponents or opponents, testify under oath with opportunity for cross examination by interested parties.

Following the public hearing, there is opportunity for additional comment on the testimony presented at the hearing. On the basis of the record, USDA issues a recommended decision on the proposed program. Subsequently, affected parties have further opportunity for filing exceptions to the recommended decision. After further analysis, if the Secretary concludes that the proposed program will carry out the objectives of the statute, a final decision and referendum order is issued. If a legally required number of producers voting in referendum approve, a final order is issued.

Under informal rulemaking, proposals for implementing the orders through regulations follow a more expeditious routine but are likewise developed publicly and in accordance with procedures of the Administrative Procedure Act.

There have been differences of opinion between SBA and USDA regarding the application of the RFA to marketing order programs. However, I want to make it clear that it has always been the intent of the USDA to comply with the intent of the RFA.

Marketing orders, and rules which flow from them, are unique in that they are normally brought about by group action of essentially small entities for their own benefit. There is no conflict between the goals of the RFA and the AMAA with respect to small businesses.

More striking than absence of conflict is the similarity between procedures. Among other things, the RFA calls for attention to:

One, the reasons why action is being considered;

Two, a clear statement of objectives;

Three, the legal basis for action;

Four, consideration of alternatives;

Five, impact on those regulated; and

Six, recordkeeping requirements.

These considerations and others are common to both statutes and no rulemaking procedure intended to carry out the objectives of the AMAA would be complete without them.

For an initial period subsequent to the enactment of the RFA, AMS operated under the advice that, with respect to the AMAA, the RFA applied only to regulations promulgated by informal rulemaking, the procedure under which regulations are issued.

However, to remove any doubt, in 1983, we began a procedure under which we request input on small business concerns in the public marketing order hearings, the early foundation of the formal rulemaking process.

The record will show that this procedure has been faithfully followed. For the most part, these proceedings, to date, have resulted in actions having application across entire industries. However, exemption of classes of activities and of minimum quantities are not uncommon.

As our experience under the RFA has evolved, we have met and otherwise communicated with the SBA counsel for advocacy staff on numerous occasions in order to address their concerns and to ensure that we have not overlooked applicable aspects of the statute.

Beyond interagency communication, the SBA has participated formally in marketing order rulemaking proceedings, not only in relation to procedure under the RFA but also in regard to the substance of the proposals under consideration.

Most of the counsel for advocacy's attention has been devoted to rulemaking on a few citrus marketing orders, and a milk order action involving the New York-New Jersey-Pennsylvania area.

We intend to continue to address the concerns of the counsel for advocacy, both formally and informally, with an objective of increasing mutual awareness on the part of both AMS and SBA.

AMS rulemaking actions are conducted under the review and approval of the office of general counsel. There has been no absence of dialog or misunderstanding with regard to our legal responsibilities. However, that office had not issued a formal opinion with regard to RFA applicability prior to the request by your committee.

On April 17, 1986, pursuant to a request of your subcommittee, the Department's office of general counsel rendered a memorandum of law relative to the applicability of the RFA to marketing orders.

Briefly, this opinion states:

> ". . . marketing agreements and orders are 'rules' under the RFA, and the procedural steps mandated by RFA must be followed with respect to every proposed agreement, order, or amendment thereto, unless the Agency can certify and substantiate that the rule would not have a significant economic impact on a substantial number of small entities."

A copy of this opinion has been forwarded to your committee under separate cover.

Mr. Chairman, we in the Agricultural Marketing Service have welcomed this opinion, as it has formalized some of our existing procedural routines, provided clarity in several areas, and identified a number of aspects in which different approaches may be considered. Of particular note is the unqualified application of the RFA to all rulemaking under the Administrative Procedures Act, including formal rulemaking.

Thus, the good faith attention to small business which we have incorporated into the marketing order hearing since 1983 as agency policy now will be considered legally mandatory.

We have yet to gain the benefit of much experience applying these standards, but we do not expect them to impede program delivery. Instead, we believe clarification of these issues will facilitate and further enhance the evidence of our compliance with the RFA.

I wish to assure the committee that we will continue to refine our efforts and explore a full range of ways to assure our rulemaking proceedings adequately address the impact of marketing order regulation on small business entities.

It will be to our benefit if the regulated community and the Small Business Administration are better informed of the factual basis of our activities. There should be no doubt of our good faith and intent.

In closing, Mr. Chairman, I would add that the recently received general counsel's opinion has led to considerable discussion within AMS about how we might better comply with the Regulatory Flexibility Act.

In addition, we have had continued discussions with representatives from SBA. Those discussions have led me to conclude that there is a need to review the agency procedures for implementing regulatory flexibility. For that reason, I intend to establish an agency study group drawn from all the disciplines represented in AMS to review our regulatory flexibility procedures and to look at the needs and desirability of developing agency guidelines for plementing regulatory flexibility and improving our analysis.

This concludes my statement, Mr. Chairman, and I will be happy to respond to any questions you or the other members may have.

Mr. **Skelton**. Well, first, we thank you, not just for being here but for the memorandum, the copy which we received and your announcement of the study group, the results of which, of course, we will look forward to.

Have you set up a timetable on that?

Mr. **Handley**. We have not, Mr. Chairman, but we will.

Mr. **Skelton**. Would you let us know?

Mr. **Handley**. Yes; we will. When we set that up, we will be happy to.

Mr. **Skelton**. By letter would be sufficient.

We do appreciate that.

Mr. **Handley**. Thank you.

[The letter referred to follows:]

United States
Department of
Agriculture

Agricultural
Marketing
Service

Washington,
D.C.
20250

June 13, 1986

Honorable Ike Skelton
Chairman
Subcommittee on Export Opportunities
and Special Small Business Problems
Committee on Small Business
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

When I testified before the Subcommittee on Export Opportunities and Special Small Business Problems on May 17, I stated my intention to conduct a review of the procedures followed within the Agricultural Marketing Service (AMS) for implementing the Regulatory Flexibility Act (RFA).

Early this week we established a study group to review AMS procedures for implementing the RFA and to evaluate the need for establishing formal agency guidelines on the subject. The study group is made up of the following persons:

CHAIRMAN

Jerry Barron, Confidential Assistant to the Administrator

VICE CHAIRMAN

Charles R. Brader, Director, Market Research & Development Division

MEMBERS

Willard H. Blanchard, Deputy Director, Dairy Division
Thomas Clark, Deputy Director, Fruit & Vegetable Division
David K. Hallett, Deputy Director, Livestock Division
Thomas M. Walsh, Assistant General Counsel, Office of General Counsel

The group represents a great deal of experience and insight regarding AMS regulatory programs, and I am confident that they will conduct a thorough review of the issues and provide a better focus for our procedures. It is my intention to report accomplishments to you when this group's work is completed.

Sincerely,

James C. Handley

JAMES C. HANDLEY
Administrator

United States
Department of
Agriculture

Agricultural
Marketing
Service

Washington,
D.C.
20250

August 27, 1986

Honorable Ike Skelton, Chairman
Subcommittee on Export Opportunities and
Special Small Business Problems
Committee on Small Business
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In response to a telephone inquiry from Ms. Brenda Pulley of your staff, I have asked the AMS task group reviewing the application of the Regulatory Flexibility Act to submit their findings to me on or about September 30, 1986.

Sincerely,

Jim Handley

JAMES C. HANDLEY
Administrator

Mr. SKELTON. Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

I too would like to commend the agency for the memorandum from the general counsel's office. I think it states this case very well, particularly page 2 on the question of economic cost.

In a test case your Department lifted marketing orders for a time, as sort of a test case to see what would happen. They then were to issue a two-part study, basically on what happened in that instance.

It is my understanding the first part was, at one point, finally released, and it basically said that it appeared nothing really happened, that more fruit was sold, that the growers seemed happy, the handlers seemed happy, the price did not go up, and more was available.

Then the marketing orders were put back on, and a second part of that study was to be released. It is my understanding that it has not been released, but what happened is, someone put some of it in one of the reports of the Council of Economic Advisers. So some of it has, in effect, been released.

I guess my question is, What is the status of that study?

As a result of that study, are you going to consider going back and lifting the orders again, or lifting them permanently for a time, since it would appear that the whole question of the economic cost was resolved by that test study?

Mr. HANDLEY. That report is still in draft form. It is going through the agencies affected for review at this time.

I believe if I do not have a copy, a copy is on the way, but we have not reviewed it at this time.

In answer to the second part of your question about what will it do, and what will we do if it reveals certain things, I would rather reserve judgment on that until I have had an opportunity to review the report.

I have not seen the second study so I do not know what it will reveal, but the first study revealed the difficulty of applying econometric standards or formulas to the prorate. There are so many uncertainties involved in that, that it does make it quite difficult, and I think that was reflected in this, and, frankly, in other studies that I am aware of that have been conducted.

Mr. LYNCH. Can we have a copy of the study when it is released publicly?

Mr. HANDLEY. Certainly.

Mr. LYNCH. For our record.

[The study referred to follows:]

United States
Department of
Agriculture

Agricultural
Marketing
Service

Washington,
D.C.
20250

July 16, 1986

Honorable Ike Skelton, Chairman
Subcommittee on Export Opportunities
and Special Small Business Problems
Committee on Small Business
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

In response to your request at the May 22 hearing on the Regulatory Flexibility Act, enclosed is the ERS study entitled "Assessment of a Marketing Order Prorate Suspension: A Study of California-Arizona Navel Oranges".

If we may be of further assistance, please let us know.

Sincerely,

James C. Handley

JAMES C. HANDLEY
Administrator

Enclosure

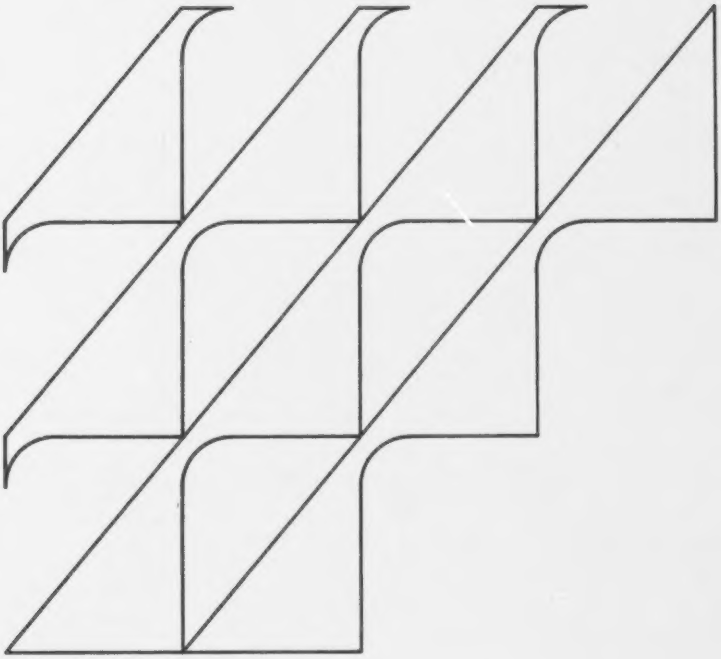
United States
Department of
Agriculture

Economic
Research
Service

Agricultural
Economic
Report
Number 557

Assessment of a Marketing Order Prorate Suspension: A Study of California-Arizona Navel Oranges

Nicholas J. Powers
Glenn A. Zepp
Frederic L. Hoff



ASSESSMENT OF A MARKETING ORDER PRORATE SUSPENSION: A STUDY OF CALIFORNIA-ARIZONA NAVEL ORANGES, by Nicholas J. Powers, Glenn A. Zepp, and Frederic L. Hoff, National Economics Division, Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report Number 557.

ABSTRACT

The market for California-Arizona navel oranges performed in about the same way during the 1984/85 season after the handler prorate was suspended as during comparable prorated periods. The industry uses a handler prorate to regulate the weekly quantity of fresh navel oranges shipped to the domestic market by placing an upper limit on the quantity each handler can sell. The prorate was suspended when fresh navel orange prices exceeded parity level during the 1984/85 season. Only minor differences existed between the prorate suspension and prorated periods in the stability of shipments and prices. Higher prices in the 1984/85 season were due to relatively small U.S. fresh orange supplies during the winter. Handler marketing practices changed very little during the partial season with a prorate suspension. The shortrun effects of a full-season prorate suspension would be lower grower prices, greater fresh use, and less processing use of available supplies.

Keywords: Marketing orders, navel oranges, handler prorate, prorate suspension, economic effects.

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1301 New York Avenue, N.W.
Washington, D.C. 20005-4788

June 1986

SUMMARY

The Federal marketing order for California-Arizona (C-A) navel oranges provides for coordinated marketing through use of handler prorates. The handler prorate, placing an upper limit on the quantity each handler can sell, enables the C-A industry to regulate the weekly shipments of navels supplied to the fresh domestic market. The C-A navel orange crop was relatively small during the 1984/85 season; prices for fresh navels exceeded the parity level. A freeze during late January in Florida and Texas further reduced supplies of fresh oranges. Consequently, the handler prorate provision of the Federal marketing order for California-Arizona navel oranges was suspended in the midst of the 1984/85 season after 52 percent of the crop had been marketed. During the 1982/83 and 1983/84 seasons, the prorate was terminated after 85 percent of the crop was marketed. Prior to the 1982/83 season, navel shipments had been prorated through nearly the entire season since the order's inception in 1953.

This report presents findings on two aspects of a handler prorate suspension. The first is a comparison of handler marketing practices and of the level and stability of prices and shipments during the prorate suspension of the 1984/85 season with those for two prorated periods. The second is an assessment of the potential effects of a season-long prorate suspension on grower prices, revenue, and product uses.

Average weekly shipments of fresh navel oranges to the domestic and export markets during the 1984/85 suspension were slightly greater than for comparable prorated periods (defined as February 7 to the end of the season) during other recent seasons. Fewer navels were used for processing during the suspension. Stability of weekly shipments to the fresh domestic, fresh export, and processing markets during the suspension did not differ from prorated periods.

Navel orange prices for both fresh and processed uses were higher during the suspension than during prorated periods. The higher prices were mostly attributable to relatively small U.S. fresh orange supplies during the 1984/85 winter. There was no consistent pattern of more or less stability in navel orange prices between the suspension and the prorate periods.

Cooperative-affiliated handlers may have been more price competitive relative to independent handlers during the suspension. The weighted average weekly f.o.b. shipper price received by cooperative-affiliated handlers was less than that for independent handlers during the 1984/85 suspension. During the prorated portion of the 1984/85 season, cooperative-affiliated handlers received a slightly higher price.

Independent handlers increased their share of the navel orange crop during the 1984/85 season. In the central California district, where most of the navel orange crop is produced, independent handlers accounted for 48 percent of the navel orange volume during the 1984/85 season, compared with 36 percent during the 1979/80-1983/84 seasons. The increase in market shares for independent handlers is probably due to an increase in the number of unaffiliated handlers.

No category of handlers seemed to benefit more than another from the suspension by shipping a larger share of their navels into the fresh market. There were no pronounced changes among the various handler categories in the share of their total volume processed during the 1984/85 season.

In the short run, a season-long suspension of the California-Arizona prorate would lead to lower grower prices for fresh navels, increased fresh navel orange use, little or no change in prices for processing navels, decreased processing navel use, and lower grower returns. The within-season effects of a suspension would be greater during large-supply seasons than during small-supply seasons. A suspension during 1982/83 (a record crop) would have generated an estimated $0.49 per box decline in grower-weighted average prices from the $2.97 actually received that season. Gross receipts would have fallen an estimated $20.2 million from the $122 million actual. During the normal-supply season (average of 1979/80-1983/84), a suspension would have caused an estimated $0.36 per box decline in grower-weighted average price and about a $16 million decline in grower revenue from the $119 million actual. During the small-supply season of 1981/82, a suspension would have resulted in an estimated $0.07 per box decline in grower-weighted average prices and a $1.9 million decline in grower revenue from the $151.5 million actual.

If changes in grower prices are transmitted through the marketing channel to the retail level, both consumer prices and total expenditures for navels would decrease with a suspension in the short term. Reductions in consumer expenditures from a suspension are greater during a large-supply season and less during a small-supply season. Per capita expenditures on navels would have declined by about 7 cents in the first year of a suspension in the large-supply season, 5 cents in the normal-supply season, and 1 cent in the small-supply season. Net economic social welfare (a summation of consumer economic gains and grower economic losses) would have been greater by 6 cents per capita in the large-supply season, 7 cents per capita in the normal-supply season, and 3 cents per capita in the small-supply season.

In the long run, a continuing suspension would lead to lower navel production than with a prorate. Fresh navel orange use would probably be no less with a continuing suspension than with a prorate and prices for fresh navels would probably be no greater. A continuing suspension would result in less processing use, but probably no change in the processing navel price.

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Assessment of a Marketing Order Prorate Suspension: A Study of California - Arizona Navel Oranges

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INTRODUCTION

Federal marketing orders for fruits, vegetables, and specialty crops allow growers to collectively market their products in interstate commerce. The Agricultural Marketing Agreement Act of 1937, the enabling legislation for Federal marketing orders, provides that provisions of the order may be used to improve the coordination of supply and demand, thus promoting stability and enhancing grower returns toward parity, but that provisions cannot be used to maintain prices above parity.1/

The Federal marketing order for California-Arizona (C-A) navel oranges provides for coordinated marketing through use of handler prorates. The handler prorate, placing an upper limit on the quantity each handler can sell, enables the C-A industry to regulate the weekly shipments of navels supplied to the fresh domestic market (the continental United States and Canada). Management of weekly shipment flows is intended to provide continuity and stability of intraseasonal shipments and prices. Each handler (shipper) is assigned a prorate each week (a fixed share of that handler's total volume of navel oranges), limiting the quantity of navels each handler can ship into the fresh domestic market.

The C-A navel orange crop was relatively small during the 1984/85 season; prices for fresh navels exceeded parity level. A freeze during late January in Florida and Texas further reduced supplies of fresh oranges. The Secretary of Agriculture suspended the handler prorate effective February 7 after the price of fresh navels continued to exceed parity level. Only 52 percent of the 1984/85 navel orange crop had been marketed when the prorate was suspended. During the 1982/83 and 1983/84 seasons, the prorate was terminated after 85 percent of the crop was marketed. Prior to the 1982/83 season, navel shipments had been prorated through nearly the entire season since the order's inception in 1953.

The suspension was controversial. Some industry members argued that weekly shipments and prices would become less stable without a prorate. Several consumer groups argued that a season-long prorate would effectively restrict the quantity of fresh navels entering the domestic market. Thus, more navels

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1/ The parity price for navels is the base price (the average price in the last 10 years divided by the index of prices received by farmers for all commodities during the last 10 years, 1910-14 = 100) times the current index of prices paid by farmers, 1910-14 = 100.

would be shipped to the fresh market with a suspension, and the increased supplies would clear the fresh market at a lower price. Grower revenue would consequently decline. Handlers were not regulated during the suspension and, thus, handlers may have changed their marketing practices in an attempt to increase their market shares and increase their share of shipments to the higher priced fresh market.

The Secretary's action raised the following questions about the potential effects of suspension. Does a suspension affect: (1) The week-to-week stability of navel orange shipments and prices? (2) The levels of fresh domestic shipments and prices? (3) The level of grower revenue? (4) The market structure and marketing practices of handlers?

This report analyzes these four issues. Navel orange price and shipment data for the prorate suspension portion of the 1984/85 season are compared with data for comparable weeks of several prorated periods to determine differences in the level and stability of prices and shipments, and changes in handler marketing practices. Because of the unusually strong demand for fresh C-A navels and relatively small fresh orange supplies during the winter of 1984/85, it was not possible to estimate grower price and income effects caused by the suspension of 1984/85. The magnitude of within-season effects of a hypothetical suspension on grower prices and revenue and on product uses are estimated for several more typical historical seasons with small, normal, and large orange supplies. The longrun effects of a continuing suspension are described without estimates of their magnitudes.

BACKGROUND

C-A navels represented only about 14 percent of total U.S. orange production, but comprised nearly 70 percent all U.S. fresh oranges marketed during the 1979/80-1983/84 winter seasons. Annual value of the navel crop averaged $128.6 million for that period.

The C-A Navel Orange Industry

The marketing season for C-A navels extends from about early November to mid-June and coincides principally with the Florida early, mid-season, and navel orange season and with the Texas orange season. Fresh C-A navels are easy to peel, have a low sugar-acid ratio, low juice content, and no seeds. They are a preferred fresh eating orange, thus selling for a price premium over fresh Florida and Texas oranges. However, C-A navels are poor processing oranges; prices for navels entering processing are lower than prices for Florida and Texas processing oranges.

Harvested area of C-A navels increased from about 62,000 acres in 1957/58 to about 115,000 in 1971/72 and stabilized thereafter. Most of this expansion occurred in central California where harvested area increased steadily from about 28,500 acres in 1953/54 to 92,000 in 1971/72, then stabilized. The expansion in central California was partially encouraged and fostered by a tax investment policy (since discontinued) which provided financial incentives for planting certain tree crops including orange groves and by ample supplies of subsidized irrigation water.

Because of stiff urban competition for land and increased irrigation water rates, harvested navel area in southern California dwindled from about 42,000 acres in 1953/54 to 15,500 in 1979/80. Arizona harvests about 4,000 acres, while northern California harvests about 1,050 acres.

Navel production in California and Arizona fluctuated around 27,000 carloads (1 carload = 1,000 cartons containing 37 1/2 pounds per carton) from the 1950's through the mid-1960's. Then, production increased steadily to a record 84,000 carloads in 1982/83 (table 1). Navel production is concentrated in central California where acreage and yields are highest. During 1983/84, central California produced about 87 percent of the industry total and southern California about 12 percent.

There are three major uses for navel oranges: fresh domestic, fresh export, and processing. Since 1979/80, about 63 percent of the crop has entered fresh domestic use and 8 percent has been exported. An average of 29 percent of the crop has been processed (products and other uses). Exports, primarily from southern California, are shipped mainly to Japan, Hong Kong, and Singapore.

Navel oranges, typically ripening during November, can be stored under refrigeration for about 10 to 14 days, but they can be satisfactorily stored on the tree for about 5 to 6 months. The internal quality of "tree-stored" navel oranges can be partially controlled by applying giberic acid to the fruit, retarding ripening. The external as well as the internal quality is vulnerable to degradation and discoloration caused by weather. Tree-stored navels can grow up to one size larger during the season. Larger fruit generally sells at a premium price which may compensate for external damage discounts.

Navels entering the fresh market are graded, packed, and sold by size. The three commonly used grades are first, choice, and standard. First grade navels are of high internal (meets certain standards of sugar-acid ratio) and external (free of scars and blemishes) quality. Choice grade navels have high internal quality, but slightly lower external quality than first grade. Standard grade navels generally exceed the minimum quality mandated by California and Arizona standards. A State maturity requirement prohibits sales of navels not meeting minimum sugar-acid ratio levels.

Fresh domestic shipments of navels are typically light in early November, reach a seasonal peak prior to Christmas week, and remain heavy from January to April when the marketing season is nearly completed. Export shipments are light and erratic before December and after April, but heavy and uniform from December through April. Processing shipments follow a seasonal upward trend and peak near the end of the marketing season because a larger share of the shipments consist of smaller, lower quality fruit.

At the beginning of each season, growers contract with handlers to pick, transport, sort, grade, pack, and ship their navel oranges. Handlers usually schedule crews to pick three times during a season because of slight variations in fruit maturity and fruit size enlargement, and to spread out grower price risk. Growers receive an average return from the fresh market weighted by the quality and quantity of their navels marketed fresh. Industry personnel knowledgeable about pricing indicate that prices for comparable quality of fresh navels in domestic and export markets are about equal. Grower returns for processing navels are computed at season's end. Grower on-tree returns for processing oranges are less than for fresh and have been negative during most seasons since 1966/67 (table 2). Negative on-tree returns

Table 1--Use and production of C-A navel oranges, 1953/54-1984/85 seasons 1/

Season	Domestic		Export		Products		Other		Total
	Cars	Percent	Cars	Percent	Cars	Percent	Cars	Percent	Cars
1953/54	22,101	77	1,877	6	4,245	14	725	3	28,948
1954/55	23,861	78	1,981	6	4,245	14	721	2	30,808
1955/56	24,801	82	1,238	4	3,328	11	782	3	30,149
1956/57	24,737	81	1,817	6	3,519	11	641	2	30,714
1957/58	16,359	91	569	3	768	4	304	2	18,000
1958/59	27,033	82	1,419	4	4,270	13	276	1	32,998
1959/60	21,641	82	1,168	4	3,301	12	409	2	26,519
1960/61	15,890	89	677	4	1,035	6	313	1	17,915
1961/62	13,158	86	448	3	1,401	9	289	2	15,296
1962/63	17,330	69	606	3	6,615	26	484	2	25,035
1963/64	24,476	79	1,101	4	4,651	15	533	2	30,761
1964/65	26,486	87	785	2	2,623	9	635	2	30,529
1965/66	27,541	71	1,579	4	8,350	23	913	2	38,383
1966/67	28,476	81	1,115	3	4,818	14	847	2	35,256
1967/68	11,132	58	647	3	7,142	37	316	2	19,237
1968/69	28,107	70	1,461	4	8,846	22	1,437	4	39,851
1969/70	31,113	69	1,826	4	10,638	24	1,474	3	45,051
1970/71	27,945	76	1,353	4	6,458	18	917	2	36,673
1971/72	31,970	68	2,056	5	11,491	24	1,259	3	46,776
1972/73	24,507	61	1,340	3	12,792	32	1,606	4	40,245
1973/74	33,246	74	1,869	4	8,899	20	1,051	2	45,065
1974/75	37,797	65	3,739	6	15,508	26	1,478	3	58,522
1975/76	37,335	64	4,431	8	15,478	26	1,219	2	58,463
1976/77	35,562	66	3,942	8	12,899	24	1,222	2	53,625
1977/78	27,421	65	3,816	9	9,634	23	1,254	3	42,125
1978/79	26,121	60	3,267	8	13,138	30	970	2	43,496
1979/80	40,101	59	4,207	6	21,942	32	2,351	3	68,601
1980/81	43,610	56	6,201	8	26,993	34	1,649	2	78,453
1981/82	38,274	69	5,115	9	10,794	20	1,295	2	55,478
1982/83	49,018	58	6,851	8	26,155	31	2,151	3	84,175
1983/84	45,917	66	5,309	8	16,732	24	1,692	2	69,650
1984/85	41,316	76	5,337	10	6,210	12	1,316	2	54,179

1/ Domestic—Volume marketed in fresh form within the continental United States and Canada subject to volume and size regulation.
Export--Volume marketed in fresh form outside the continental United States and Canada exempt from volume and size regulation.
Products--Volume processed into products, including juice, exempt from volume and size regulation.
Other—Includes oranges donated for charitable purposes, shipped via railway express or parcel post, sold directly to consumers by producers, and disposed of otherwise as unfit for human consumption, exempt from volume and size regulation.

Source: Navel Orange Administrative Committee (NOAC).

Table 2—Grower prices for C-A navels

Season	Fresh	Products	Weighted average
	Dollars per box, on-tree equivalent		
1954/55	2.46	0.15	2.14
1955/56	2.96	.06	2.64
1956/57	2.88	.44	2.60
1957/58	4.53	.54	4.36
1958/59	3.06	1.10	2.81
1959/60	3.67	.42	3.26
1960/61	5.24	.48	4.96
1961/62	5.92	.74	5.43
1962/63	5.20	.88	4.05
1963/64	3.56	1.21	3.20
1964/65	3.44	.54	3.19
1965/66	2.80	.06	2.18
1966/67	2.90	-.38	2.44
1967/68	5.84	.10	3.60
1968/69	2.94	-.26	2.19
1969/70	2.84	-.24	2.09
1970/71	3.50	-.36	2.80
1971/72	2.92	-.34	2.09
1972/73	4.31	-.60	2.68
1973/74	3.85	-.87	2.88
1974/75	3.67	-1.06	2.37
1975/76	3.02	-.88	1.96
1976/77	3.54	-.98	2.42
1977/78	6.50	-.80	4.75
1978/79	8.02	-.29	5.42
1979/80	4.00	-.39	2.73
1980/81	4.90	-1.30	2.61
1981/82	7.24	-1.04	5.58
1982/83	4.58	-.46	2.95
1983/84	5.66	-1.24	3.95
1984/85	10.94	.96	9.77

Source: National Agricultural Statistics Service, U.S. Dept. of Agr.

mean that the processing plant price did not cover average picking, hauling, and handling costs.2/

The number of navel growers declined from about 7,500 in 1954/55 to 3,962 in 1983/84. Average operation size was 28 acres in 1983/84. Central California operations averaged 37 acres, while southern California operations averaged 12 acres.

Handlers market navels either independently or through a marketing cooperative. Handlers operating independently provide all necessary marketing services from the shipper to the wholesaler or retailer. Such a handler is called an independent or unaffiliated handler. A handler marketing through a cooperative is called a cooperative-affiliated handler. The cooperative provides various marketing services from the shipper to retailer. Marketing services include identifying prospective buyers for the handler, handling transportation arrangements, settling any buyer grievances, and promotional activities. Sunkist is the largest federated marketing cooperative for handlers of citrus fruits, followed by Pure Gold. Most handlers are members of marketing cooperatives. In 1984/85, cooperative-affiliated handlers marketed nearly 80 percent of southern California's production and slightly less than 50 percent of central California's production. There were 125 handlers in the industry in 1983/84.

Federal Marketing Order No. 907

A Federal marketing order for C-A navels has been in effect almost continuously since 1933. Federal Marketing Order No. 907, the present order for C-A navel oranges approved in 1953, authorizes a handler prorate, size standard, and marketing research. A size standard may place a minimum or maximum restriction, or both, on the sizes of the navel oranges that can be marketed. Size standards have been used infrequently. The handler prorate establishes a maximum quantity of navels that each handler can ship into the fresh domestic market (the continental United States and Canada) each week.3/ As a share of total production, the fresh export market for navels is relatively minor, less than 10 percent, and is not prorated. Navels not sold in the fresh market during a given week must be left on the tree for shipment in subsequent weeks or diverted to processing.

Administration of Handler Prorate

The industy established four geographic districts to administer the market order. District 1, or central California, is basically the San Joaquin Valley. District 2, or southern California, includes the region west of Palm Springs and south of Bakersfield. District 3, or Arizona-Desert Valley, includes Arizona and the eastern desert of southern California. District 4, or northern California, includes the Sacramento area and extends slightly north of Sacramento.

2/ Picking and shipping navels which enter processing is profitable for growers even though on-tree grower returns cover only part of the picking and hauling costs. Navels used in processing represent a part of the production base from which the prorate for the fresh domestic market is calculated. For a grower, a larger production base means a larger prorate.

3/ While the marketing order was approved by growers, the provisions of the order are administered through handlers.

At the onset of each marketing season, the Navel Orange Administrative Committee (NOAC) develops a marketing policy and submits it to the U.S. Department of Agriculture for review.4/ The policy contains information on early season crop estimates, fruit size and quality, a discussion of the intended use of the size restriction provisions, and a breakdown of the percentage and absolute levels of the crop to be marketed into the fresh domestic, export, and processing markets. The breakdown of the crop use is developed from the notion of best "economic utilization of the crop," say industry officials. In practice, this has meant that a larger share of the crop enters processing during seasons when there are relatively large supplies, while a smaller share of the crop enters processing during small-supply seasons.

As a first step toward providing equitable marketing opportunity among districts, the NOAC establishes an identical fresh domestic use percentage (called the equity factor) in each of the districts. A preliminary handler utilization schedule contains weekly prorate quantities developed from the equity factor. This schedule is revised periodically through the season by the NOAC in response to new information on size distribution and quality of the crop, supplies, availability of substitutes, and demand conditions.5/

NOAC usually begins to prorate in mid-November when fresh domestic shipments begin to increase. At a public meeting each Tuesday morning, it discusses and votes on whether to have or not have a prorate in each of the districts, the industry prorate quantity for the subsequent 2 weeks, early maturity or freeze allotment, and size regulations.6/ The following Tuesday morning, NOAC reviews the implications of any new market information and then votes to either maintain or increase the prorate established at the preceding Tuesday meeting. NOAC cannot decrease the prorate quantity established the previous Tuesday. The weekly prorate level voted on by NOAC is subject to review and approval by the Secretary of Agriculture.

Prorates are administered by the NOAC through handlers. The prorate legally binds each handler to an upper limit on weekly shipments to the fresh domestic market. The prorate for each handler equals the share of the district production contracted by the handler multiplied by the district's prorate quantity with an adjustment for any handler loan repayments and overshipments from preceding weeks. Several procedures--intra- and interdistrict prorate loans (through other handlers), early maturity and freeze allotments, up to 10-percent overshipments three times per season, and up to 20-percent overshipment one time per season--permit the level of navel orange shipments into the fresh domestic market to slightly exceed the prorated quantity during a given week.

PRICES, SHIPMENTS, AND MARKETING PRACTICES

Weekly shipments of fresh navel oranges to the domestic and export markets during the 1984/85 suspension were slightly greater than during comparable

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4/ NOAC is composed of 11 voting members (5 growers, 5 handlers, and a nonindustry member).

5/ Individual handler prorates are not affected by the quality of the handler's contracted navel oranges nor the quantity of export shipments.

6/ Handlers with matured or freeze damaged navels can request NOAC for early maturity or freeze allotments allowing them to ship in excess of their weekly prorate.

weeks of the prorated periods. Fewer navel oranges were used for processing. Prices for both fresh and processed navels were higher during the suspension. Higher prices during the 1984/85 season were mostly attributable to a relatively small supply of fresh oranges during the winter. Navel prices were not consistently more, nor less, stable during the suspension than during the prorated periods. Independent handlers marketed a larger share of the total navel crop during the 1984/85 season than during the 1979/80-1983/84 seasons.

This section examines differences in prices and shipments between the weeks of the 1984/85 suspension and those for comparable weeks of earlier prorated periods. The 1984/85 suspension began on February 7, 1985, and extended through the remainder of the season. To better understand how the market performed from approximately the middle of the season to the end, we made price and shipment comparisons among seasons only for those weeks following February 7.[7]

The two prorated periods used for comparison were the five seasons 1979/80 through 1983/84 and the 1981/82 season. Average U.S. winter season fresh orange supply during the 1979/80-1983/84 seasons was about 40 percent greater than during 1984/85 and the average navel supply was 35 percent greater (table 3).

The 1981/82 season was chosen as a second comparison prorated period because supplies were more similar to those for the 1984/85 season. While U.S. winter season fresh orange supplies in 1981/82 were 15 percent greater than in 1984/85, the navel supply was only 2 percent greater.

Since fresh orange supplies during the two prorated periods are different from the 1984/85 season, differences in level and stability of prices and shipments among prorated and the suspension periods cannot be attributed solely to the suspension. Differences in supply and demand conditions between the seasons contribute to the price and shipment outcomes, disguising the true effects of the suspension.

Reported prices were collected at five levels in the navel marketing channel. At the grower level, prices before and after picking were measured with the monthly California fresh and processing estimated-on-tree (e.o.t.) and packing-house-door (p.h.d.) navel prices. At the handler level, shipper f.o.b. prices from the major navel producing regions--southern and central California--were assembled. Midweek f.o.b. prices were further disaggregated into first and choice grades, the two major grades of fresh navels, and by the major fruit sizes 56 (large), 72, 88, and 113 (small). Midweek prices for first grade fresh navels of sizes 48 through 113 were from three major regional wholesale markets: New York City, Chicago, and Los Angeles. Monthly retail prices were for fresh navels sold in U.S. urban areas.

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[7] The number of weeks from February 7 to the end of the 1984/85 season differed from the number for earlier prorated seasons. This is partially due to different crop sizes and to the prorate. Larger supplies of navels and the prorate each contribute to a longer season. Season length directly affects the average weekly shipment level. For a given supply, the longer the season, the smaller the average weekly shipment level. Thus, the level and stability of weekly shipments can be sensitive to the weeks selected for comparison.

Table 3--Average U.S. fresh orange supplies during the winter seasons of the 1979/80-1983/84 and 1981/82 prorated periods and the 1984/85 suspension

Period	Crop	Quantity
		100,000 lbs.
Prorated:		
1979/80 to 1983/84	C-A navels	26,726
	Florida early, navels, and midseason	5,075
	Texas	2,207
	Total, United States	34,008
1981/82	C-A navels	20,804
	Florida early, navels, and midseason	4,436
	Texas	2,822
	Total, United States	28,062
Prorate suspension:		
1984/85	C-A navels	20,317
	Florida early, navels, and midseason	3,976
	Texas	0
	Total, United States	24,293

Source: National Agricultural Statistics Service, U.S. Dept. of Agr.

Each price series was deflated to remove general price trends and price trends due to changes in the amount of marketing services embodied in fruit prices. Retail prices were deflated by the urban consumer price index for food. Wholesale prices were deflated by the wholesale price index for fresh fruits. Prices at the f.o.b., p.h.d., and e.o.t. levels were deflated by the index of prices received by farmers for all commodities.

Findings for prices and shipments are presented as differences in outcomes between the suspension portion of the 1984/85 season and the comparable weeks of the 1981/82 and the 1979/80-1983/84 prorated periods. Findings for handler marketing practices are presented as differences in outcomes between the 1984/85 season and the 1979/80-1983/84 seasons.

Shipment Stability

Stability of intraseasonal shipments and prices was measured with the coefficient of variation (c.v.).8/ A larger c.v. value indicates greater

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8/ The c.v. is a measure of the relative dispersion of observations about their mean. The c.v. is the standard deviation (s.d.) of a variable such as shipments or prices divided by the absolute value of the mean of the variable.

relative variability about the mean and, thus, less stability than a smaller value. Stability of weekly shipments was essentially the same during the 1984/85 suspension as during the two prorated periods (table 4). Although the c.v. for fresh domestic shipments was slightly smaller during the 1984/85 period, magnitude of the difference was inconsequential.

Price Stability 9/

Prices were not consistently more, nor less, stable during the suspension than during the prorate periods. At some levels of the marketing channel, prices were more stable during the suspension. At other levels, prices were less stable during the suspension. The c.v.'s for grower e.o.t. returns for both fresh and processing navels during the suspension fell between those of the two prorated periods (table 5). Prices for both fresh and processing navels at the p.h.d. level were more stable during the suspension.

Table 4--Mean, s.d., and c.v. of weekly industry shipments of C-A navel oranges during the 1979/80-1983/84 and 1981/82 prorated periods, and the 1984/85 suspension 1/

Use and period	Observations	Mean	Standard deviation	Coefficient of variation
	Number	1,000 cartons		c.v.
Fresh domestic:				
1979/80-1983/84	102	1,230	730	0.59
1981/82	16	1,268	818	.65
1984/85	15	1,332	696	.52
Fresh export:				
1979/80-1983/84	83	156	121	.78
1981/82	13	144	110	.76
1984/85	14	126	98	.78
Processing:				
1979/80-1983/84	110	758	485	.64
1981/82	16	438	287	.66
1984/85	14	280	175	.63

1/ Weekly shipments for the weeks after February 7 (effective start of prorate suspension) to the end of the season.

Source: Weekly shipment data are from the NOAC.

9/ F-tests were calculated to examine whether variances of various prices during the suspension were significantly different from those during prorated periods. Results are shown in appendix tables 1 and 2.

Table 5--Mean, s.d., and c.v. of deflated estimated-on-tree and packing-house-door prices for C-A navels during the 1979/80-1983/84 and 1981/82 prorated periods, and the 1984/85 suspension

Deflated price series, use, and period 1/	Observations	Mean	Standard deviation	Coefficient of variation
	Number	Dollars per carton		c.v.
Estimated-on-tree:				
Fresh--				
1979/80-1983/84	27	3.26	1.37	0.42
1981/82	5	5.68	.33	.06
1984/85	4	8.48	2.32	.27
Processing--				
1979/80-1983/84	29	-.62	.27	.43
1981/82	5	-.77	.01	.02
1984/85	4	1.01	.32	.32
Packing-house-door:				
Fresh--				
1979/80-1983/84	27	4.39	1.41	.32
1984/85	4	9.64	2.38	.25
Processing--				
1979/80-1983/84	29	.51	.32	.63
1984/85	4	2.21	.28	.13

1/ Monthly prices from February 7 (effective start of prorate suspension) to the end of the season. Prices deflated by the index of prices received by farmers for all farm commodities, 1977 = 100.

Source: National Agricultural Statistics Service, U.S. Dept. of Agr.

Fresh navel prices at f.o.b. showed no consistent pattern of change in stability (table 6). F.o.b. prices were more stable during the prorated periods for some grades and sizes in some districts. In other cases, f.o.b. prices were less stable during the prorated periods. F.o.b. prices of all sizes of first grade fresh navels from central California were more stable during the suspension. However, f.o.b. prices for all sizes of choice grade fresh navels (except the smallest size) from central California were less stable during the suspension. The f.o.b. prices for all sizes of first and choice grade navels from southern California were more stable during the suspension than during the prorated period.

Wholesale prices were more stable for first grade navel oranges sold in New York City, Chicago, and Los Angeles during the suspension than during the prorated periods (table 7). Retail prices for fresh navels sold in urban areas were slightly less stable during the suspension (table 8).

Table 6—Mean, s.d., and c.v. of deflated f.o.b. prices for C-A navels during the 1979/80-1983/84 and 1981/82 prorated periods, and the 1984/85 suspension

Deflated price series, use, grade, and fruit size	Period 1/	Observations	Mean	Standard deviation	Coefficient of variation
		Number	Dollars per carton		c.v.
California, f.o.b., fresh	1979/80-1983/84	27	7.74	1.40	0.18
	1984/85	4	13.70	2.43	.18
Central California f.o.b., fresh, first:					
56	1979/80-1983/84	75	4.97	1.21	.24
	1981/82	12	5.26	.12	.02
	1984/85	12	7.16	1.00	.14
72	1979/80-1983/84	75	4.72	.70	.15
	1981/82	12	5.46	.15	.03
	1984/85	12	7.15	1.11	.16
88	1979/80-1983/84	75	4.44	.87	.20
	1981/82	12	5.68	.29	.05
	1984/85	12	7.05	1.40	.20
113	1979/80-1983/84	75	4.21	1.07	.25
	1981/82	12	5.60	.04	.01
	1984/85	12	6.91	1.48	.21
138	1979/80-1983/84	75	3.94	1.23	.31
	1981/82	12	5.60	.04	.01
	1984/85	12	6.38	1.00	.16
Southern California, f.o.b., fresh, first:					
56	1979/80-1983/84	38	5.56	1.40	.25
	1984/85	8	7.64	.64	.08
72	1979/80-1983/84	38	5.26	.77	.15
	1984/85	8	7.51	.35	.05
88	1979/80-1983/84	38	5.28	1.00	.19
	1984/85	8	6.95	.13	.02
113	1979/80-1983/84	38	4.84	1.04	.22
	1984/85	8	6.30	.38	.06
138	1979/80-1983/84	38	6.48	.49	.08
	1984/85				
Central California, f.o.b., fresh, choice:					
56	1979/80-1983/84	83	4.38	.89	.20
	1984/85	13	5.78	1.20	.21
72	1979/80-1983/84	83	4.33	.68	.16
	1984/85	12	5.64	1.18	.21
88	1979/80-1983/84	83	4.26	.77	.18
	1984/85	13	5.91	1.44	.24
113	1979/80-1983/84	81	4.18	.85	.20
	1984/85	13	5.86	1.47	.25
138	1979/80-1983/84	75	4.05	.82	.20
	1984/85	13	5.36	.91	.17
Southern California, f.o.b., fresh, choice:					
56	1979/80-1983/84	26	4.76	1.39	.29
	1984/85	8	5.14	.18	.04
72	1979/80-1983/84	26	4.67	0.56	.12
	1984/85	8	5.16	0.36	.07
88	1979/80-1983/84	26	5.00	.78	.16
	1984/85	8	5.07	.42	.08
113	1979/80-1983/84	26	4.79	.73	.15
	1984/85	8	4.98	.39	.08
138	1979/80-1983/84	26	4.60	.99	.22
	1984/85	8	4.78	.38	.08

1/ Midweek and monthly prices from February 7 (effective start of prorate suspension) to the end of the season. Prices are deflated by the index of prices received by farmers for all farm commodities, 1977 = 100.

Source: California f.o.b., National Agricultural Statistics Service, U.S. Dept. of Agr.; central California and southern California first and choice f.o.b., Federal-State Market News Service, U.S. Dept. of Agr.

Table 7--Mean, s.d., and c.v. of deflated wholesale prices in selected cities for C-A navels during the 1979/80-1983/84 prorated period and the 1984/85 suspension

Deflated price series, use, grade, and fruit size	Period 1/	Observations	Mean	Standard deviation	Coefficient of variation
		Number	Dollars per carton		c.v.
New York City, wholesale, fresh, first:					
48-113	1979/80-1983/84 2/	51	8.04	1.22	0.15
	1984/85	12	8.85	.71	.08
Chicago, wholesale, fresh, first:					
56	1979/80-1983/84	83	8.54	1.94	.23
	1984/85	12	8.93	.79	.09
72	1979/80-1983/84	86	8.06	1.15	.14
	1984/85	12	8.91	.77	.09
88	1979/80-1983/84	88	7.63	1.15	.15
	1984/85	12	8.77	.74	.08
113	1979/80-1983/84 3/	69	7.29	1.13	.16
	1984/85	12	8.67	.78	.09
Los Angeles, wholesale, fresh, first:					
56-113	1979/80-1983/84 2/	47	5.95	.83	.14
	1984/85	11	7.10	.41	.06

1/ Midweek prices from February 7 (effective start of prorate suspension) to the end of the season. Prices are deflated by the wholesale price index for fresh fruits, 1977 = 100.

2/ Data were available for only 1981/82-1984/85.

3/ Data were available for only 1979/80 and 1981/82-1984/85.

Source: Federal-State Market News Service, U.S. Dept. of Agr.

Table 8--Mean, s.d., and c.v. of the deflated retail price for C-A navels in urban areas during the 1979/80-1983/84 prorated period and the 1984/85 suspension

Period 1/	Observations	Mean	Standard deviation	Coefficient of variation
	Number	Cents per pound		c.v.
1979/80-1983/84	20	13.9	1.0	0.07
1984/85	4	17.6	2.0	.11

1/ Monthly prices from February 7 (effective start of prorate suspension) to the end of the season. Prices are deflated by the consumer price index (urban) for food, 1967 = 100.

Source: Bureau of Labor Statistics, U.S. Dept. of Labor.

Shipment Levels

Average weekly fresh domestic navel shipments were greater during the suspension than during the prorated periods. But average weekly fresh export and processing shipments were smaller during the suspension. The average quantity shipped per week to the fresh domestic market during the 1984/85 suspension was 8 percent greater than during the 1979/80-1983/84 prorated period and 5 percent greater than during the 1981/82 prorated period (table 4). The average quantity shipped per week to the export market was 13 percent less during the suspension, compared with the 1981/82 season, and 19 percent less than during the 1979/80-1983/84 period. The average of weekly shipments of all fresh navels was 3 percent greater during the suspension than during the 1981/82 prorated period and 5 percent greater than during the 1979/80-1983/84 prorated period. The average of weekly processing shipments was 36 percent less during the suspension than during the 1981/82 season and 63 percent less than during the 1979/80-1983/84 prorated period.10/

Price Levels 11/

Fresh navel prices at all marketing levels were higher during the 1984/85 suspension than during the prorated periods (tables 5-8). Prices of navel oranges for processing also were higher during the 1984/85 period than during the other periods. The higher prices were mostly attributable to relatively small fresh orange supplies during the 1984/85 winter season.

10/ Although seasonal navel supplies were about 3 percent less in 1984/85 than in 1981/82, seasonal fresh domestic shipments were about 8 percent greater, export shipments were about 4 percent greater, and processing shipments were about 38 percent less (table 1). Seasonal navel supplies were about 24 percent less in 1984/85 than the average during 1979/80-1983/84, and seasonal fresh domestic shipments were about 5 percent less, export shipments were about 3 percent less, and processing shipments were about 66 percent less.

11/ t-tests were calculated to examine whether means of deflated prices during suspension were significantly different from those during prorated period. Results are shown in appendix tables 1 and 2.

Handler Marketing Practices

Three aspects of handler marketing practices were examined: (1) price competitiveness among handler groups, (2) the share of district production shipped by various handler groups, and (3) the shares of total shipments sent to processing by various handler groups.

Weighted average f.o.b. prices for the 1984/85 season were computed for selected handlers according to their marketing organization affiliation.[12] The weeks prior to the suspension constituted the prorated period. Price competitiveness among cooperative-affiliated and independent handlers was determined by comparing their weighted average f.o.b. prices during the prorated and suspension periods. Cooperative-affiliated handlers may have been more price competitive during the suspension than were independent handlers. The weighted average weekly f.o.b. shipper price was slightly greater for cooperative-affiliated handlers than for independent handlers during the prorated portion of the 1984/85 season (table 9). However, the weighted average weekly price received by cooperative-affiliated handlers was less than that received by the independent handlers during the suspension.

Handlers were grouped each season according to their relative size (total shipments), district location, district origin of shipments, and whether they were affiliated with a cooperative marketing organization or were

Table 9--Mean, s.d., and c.v. of the deflated independent handler f.o.b. price and the deflated cooperative-affiliated handler f.o.b. price for C-A navels during the 1984/85 prorated and the 1984/85 suspension periods

Handler category and 1984/85 period 1/	Observations	Mean	Standard deviation	Coefficient of variation
	Number	Dollars per carton		c.v.
Cooperative:				
Prorate	15	6.98	0.55	0.08
Suspension	12	6.34	.80	.13
Independent:				
Prorate	15	6.90	.29	.04
Suspension	12	6.66	1.26	.19

1/ The f.o.b. prices are for the weeks of the 1984/85 season. The weeks from the beginning of the 1984/85 season to February 7, 1985 (effective start of suspension) form the prorate period, and the weeks from February 7, 1985, to the end of the season form the suspension period. Prices are deflated by the index of prices received by farmers for all farm commodities, 1977=100.

Source: Weekly prices from NOAC.

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[12] F.o.b. prices are from a sample of medium and large handlers providing prices to NOAC.

independent.13/ Market share controlled by each handler category and the share of each handler category's shipments entering the processing market relative to the district's share in the 1984/85 season were compared with the average during the 1979/80-1983/84 seasons.

Independent handlers in district 1 marketed a larger share of their district's shipments during the 1984/85 season than during the prorated 1979/80-1983/84 seasons. The largest change occurred in the share of district 1 production handled by medium-size independent handlers (table 10). Ten medium-size independent handlers marketed 19.7 percent of district 1 production during the 1984/85 season. But, five to seven medium-size independent handlers marketed only 9.2 percent of district 1 production during the 1979/80-1983/84 seasons.

Cooperative affiliated handlers marketed a smaller share of district 1 production during 1984/85 than during 1979/80-1983/84. Twenty-nine cooperative-affiliated handlers marketed 46.5 percent of district 1 production during 1984/85, compared with between 26 to 32 cooperative-affiliated handlers who marketed an average of 60.9 percent of district 1 production during 1979/80-1983/84. The shift in market shares of district 1 production from cooperative-affiliated to independent handlers is probably due to an increase in the number of medium- and large-size independent handlers during 1984/85.14/ Market shares among handler categories in district 2 changed little during 1984/85.

The prorate, as administered by the NOAC, provides each handler, regardless of size, with equal access (in proportion to total shipments) to the regulated higher priced fresh domestic market. Handlers in each district, consequently, ship about the same share of their total shipments into the relatively lower priced processing market. With a suspension, however, some handlers could market a larger share of their navels into the higher priced fresh market and, thus, return a higher average price to their growers. This could happen because of differing marketing practices among handlers, better quality navel oranges among some handlers, or both.

The difference between each handler category's share of shipments entering processing and the average share for the district was computed to determine whether handlers in some categories marketed a smaller share of their shipments into processing during 1984/85. The resulting differences were compared with those for the 1979/80-1983/84 seasons to determine whether the relative share of processing shipments for particular handler categories changed.

No pronounced changes occurred in the various handler group's relative share of shipments to the processing market during the 1984/85 season, compared with the average for the 1979/80-1983/84 seasons. This suggests that no handler category benefited more than another during the 1984/85 season by shipping a relatively smaller share of their navel oranges into the lower priced processing market.

13/ District 3 shipment data were not examined because it had completed its marketing before the effective suspension.

14/ Most growers make contractual arrangements with handlers to market their navels at the onset of the market season. These contractual arrangements minimize shifting of growers among handlers during the market season.

Table 10—Handler category share of district shipments of C-A navels to all markets and handler category share of processing shipments less the district share of processing shipments, during the 1979/80-1983/84 season, and the 1984/85 season

District and handler category	Period	Handlers	Handler share of district shipments to all markets: Range	Handler share of district shipments to all markets: Average	Handler share of processing shipments less the district's share: Range	Handler share of processing shipments less the district's share: Average
		Number	Percent			
District 1 handler and district 1 shipment orgin:						
Small cooperative	1979/80-1983/84	8-12	6.3 to 8.9	7.6	-3.4 to 2.7	0
	1984/85	11	—	6.1	—	1.1
Medium cooperative	1979/80-1983/84	12-13	23.9 to 28.4	26.2	-2.4 to 4.3	.8
	1984/85	12	—	19.8	—	1.7
Large cooperative	1979/80-1983/84	6-7	23.7 to 28.6	26.1	-2.3 to 16.6	6.7
	1984/85	6	—	22.6	—	1.3
Small independent	1979/80-1983/84	7-15	1.5 to 2.9	2.2	-6.5 to 1.0	-2.4
	1984/85	17	—	3.0	—	2.5
Medium independent	1979/80-1983/84	5-7	8.3 to 11.2	9.2	-6.5 to 1.5	-1.8
	1984/85	10	—	19.7	—	-2.3
Large independent	1979/80-1983/84	5-7	23.4 to 27.4	25.0	-6.3 to -0.1	-2.3
	1984/85	6	—	25.9	—	-2.0
District 2 handler and district 1 shipment orgin:						
Cooperative	1979/80-1983/84	3-5	2.5 to 4.2	3.4	-5.1 to 4.8	-.3
	1984/85	8	—	2.8	—	.7
Independent	1979/80-1983/84	2/	.2 to .5	.3	-22.5 to -2.0	-11.5
	1984/85	2/	—	.1	—	-.6
District 1 handler and district 2 shipment orgin:						
Cooperative	1979/80-1983/84	2/	3.2 to 5.8	4.3	-15.9 to -10.1	-13.4
	1984/85	2/	—	—	—	—
Independent	1979/80-1983/84	2/	1.7 to 2.6	2.0	-22.0 to 3.9	-6.1
	1984/85	2/	—	6.5	—	-6.9
District 2 handler and district 2 shipment orgin:						
Small cooperative	1979/80-1983/84	8-10	25.1 to 28.9	26.6	-.5 to 9.7	2.6
	1984/85	9	—	24.0	—	-1.1
Large cooperative	1979/80-1983/84	4	49.0 to 52.4	50.9	-.3 to 4.4	1.1
	1984/85	4	—	52.4	—	2.3
Independent	1979/80-1983/84	7-9	15.4 to 16.5	16.2	-5.3 to 13.9	0
	1984/85	7	—	17.1	—	-1.4
District 4 handler and district 4 shipment orgin:						
Cooperative	1979/80-1983/84	2/	73.6 to 89.3	82.1	-.3 to .1	-.9
	1984/85	4	—	92.1	—	-3.4
Independent	1979/80-1983/84	6-8	10.7 to 26.4	17.9	-10.8 to 19.9	-3.8
	1984/85	9	—	7.9	—	.3

— = No range or average.

1/ A negative value indicates that the share of shipments going to the processing market was less for the handler category than the average for all handlers in the district.

2/ To prevent information disclosure, the number of handlers is not reported if there were fewer than four.

Source: NOAC.

Most handler categories in districts 1 and 2 marketed nearly the same share of their shipments to the processing market, relative to their district's share during 1984/85, compared with the preceding five seasons. Large cooperative-affiliated handlers were an exception, marketing a slightly smaller share of their shipments into the processing market relative to their district's share.

ECONOMIC EFFECTS OF A PRORATE SUSPENSION

Relationships in prices, product use, and production of navel oranges suggest that a season-long prorate results in the diversion of some fresh marketable navels from the fresh domestic market to processing. Over time, grower prices have increased for fresh navels and decreased for processing navels (table 2). This has occurred as the share of production entering fresh use has declined and the share to processing use increased (table 1). Furthermore, production has increased. These observations are consistent with theoretical expectations of product diversion.

The shortrun (within-season) effects of suspending the prorate would be lower fresh navel prices and higher fresh use.15/ Processing use would decline, but processing prices would probably not change since the California-Arizona navel orange industry is a price-taker in the processing market. Grower revenue would fall below what it would be with a prorate. Continuation of a suspension would probably lead to a reduction in navel acreage below that which would exist with a prorate. This section presents estimates of the likely within-season effects of a prorate suspension on navel orange prices and grower revenue.

Procedure

The within-season effects of a suspension on uses, prices, and grower revenue are sensitive to the level of navel supplies. Because navel supplies fluctuate year-to-year in response to the weather, the shortrun effects of a suspension are estimated for three crop-sizes: small, normal, and large. Seasons selected as representative were 1981/82 (small supply), 1979/80-1983/84 average (normal supply), and 1982/83 (large supply).

The within-season effects of a suspension were determined by comparing the actual prices and uses during these three prorated periods with estimates of prices and uses had there not been a prorate. The total volume of navels was assumed unchanged in the short run following a suspension. The underlying proposition in the analysis was that with a prorate some fresh marketable navels may be withheld from the fresh market.16/ During a suspension, handlers were assumed to market all fresh-marketable navels in the fresh

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15/ The short run is a period too short for navel orange production adjustments to occur due to a change in grove investments. Because of the high fixed costs of grove investments, the short run for removal of navel orange groves may vary from 1 to 20 years. Including the gestation period, the short run for expansion is 5-7 years. Shortrun effects in this report refer to those occurring within the first season of a suspension.

16/ "Fresh-marketable" refers to those navels which are profitable to sell fresh in a "free-market" setting. Such oranges must return a price at least high enough to cover variable packing and selling costs plus their value in processing use (opportunity cost).

markets. Only oranges that could not be profitably sold in the fresh market were assumed to go to processing. The critical variables in estimating prices and uses under a prorate-suspension scenario are: (1) free-market processing-use percentages and (2) changes in fresh and processing prices resulting from changes in the quantity of navel oranges entering the various uses. Relationships between product prices and quantity are measured by "price flexibilities."[17]

Processing-Use Percentage

The share of the crop which is fresh-marketable varies year-to-year in response to crop size and weather and marketing conditions. In a large-supply season (with heavy fruit set), a larger share of the crop typically consists of smaller navels which are not fresh-marketable.[18] Information provided by industry personnel knowledgeable about the grading and marketing of navels revealed that in a large-supply season, 16-24 percent (20 percent chosen as most likely) of the navels are typically not fresh-marketable. In a normal-supply season, 15-21 percent (18 percent chosen as mostly likely) of the navels are not fresh-marketable. And, in a small-supply season, 12-18 percent (15 percent chosen as the most likely) of the navels are not fresh-marketable. Processing uses with a suspension were calculated by multiplying the supply of navels during the representative season by the corresponding free-market processing use percentage. Fresh uses were calculated as the total supply less processing use less other use.

Price Flexibilities

Price flexibilities were based on statistical analyses of the relationship between price and quantities of navels shipped into the various markets.[19] Price flexibilities were estimated using actual quantities and prices for the representative seasons. Price flexibilities equal to two standard deviations above and below the estimated values were used to represent the most probable range of values for the price flexibilities. In the small-supply season, the price flexibility for fresh navels was estimated to be between -1.11 and -1.63 (-1.37 as most likely), between -1.64 and -2.16 (-1.9 as most likely) during the normal-supply season, and between -1.97 and -2.49 (-2.23 as most likely) in a large-supply season. A price flexibility of zero was estimated for processing navels, indicating that changes in processing use had no effect on processing navel prices. This means that the C-A navel orange industry is a price-taker in the processing market. These price flexibilities were calculated in a similar way to those estimated by Thor and Jesse and are of similar magnitudes.[20]

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[17] A price flexibility is the percentage change in price associated with a 1-percent change in the quantity of navel oranges marketed in a given use.

[18] During large-crop seasons, prices for some navel oranges (small and/or lower grade) may be lower than the total of packing and selling costs and the value of the navel in processing. In such cases, returns are higher from processing use. Such navels would be included in the processing-use percentage. During small-crop seasons, higher prices may make it profitable to ship marginal quality navels to the fresh market, resulting in a lower processing-use percentage.

[19] See Appendix for a discussion of the statistical analysis.

[20] P.K. Thor and E.V. Jesse. Economic Effects of Terminating Federal Marketing Orders for California-Arizona Oranges, Econ. Res. Serv., U.S. Dept. Agr., TB-1664, Nov. 1981.

Shortrun Economic Effects of a Suspension

The within-season effects of a suspension were estimated as the difference between the estimated use, price, and grower revenue for the representative seasons and actual values for those seasons with a prorate in place.

Normal-Supply Season

Shortrun effects of a suspension in a normal supply season are: (1) increased fresh use, (2) decreased processing use, (3) decreased fresh market prices, and (4) decreased total grower revenue. Fresh use increases by an estimated 7,694 carloads to 56,615, a 16-percent increase, as more fresh-marketable navels enter the fresh markets (table 11).[21] Processing use consequently decreases to an estimated 12,829 carloads, a 37-percent decline. Total grower revenue decreases to an estimated $107 million, a 10-percent decrease from about $119 million. Grower revenue from the fresh markets decreases to an estimated $112 million, a decrease of about $16 million. Because of the negative on-tree returns for products, grower revenue losses from products decrease by $3.3 million to an estimated $-5.5 million.

Large-Supply Season

The 1982/83 navel crop, representing the large-supply season, was a record crop in California and Arizona. With a suspension, fresh use increases by an estimated 9,320 carloads to about 65,189, a 17-percent increase (table 12).[22] Processing use decreases by an estimated 9,320 carloads to about 16,835, a 36-percent decrease. Total grower revenue decreases by $20 million to an estimated $102 million.

Small-Supply Season

Effects of a suspension during a small-supply season are similar to those for normal- and large-supply seasons: processing use decreases, fresh use increases, and grower prices and gross revenue decrease. The magnitude of the effects are smaller during a short-supply season because fewer fresh-marketable oranges are diverted from fresh to processing use by prorate.

With a suspension, fresh use increases by an estimated 2,472 carloads, a 6-percent increase to 45,861 carloads (table 13).[23] Processing use decreases by an estimated 2,472 carloads, a 23-percent decrease, to 8,322 carloads. As a result, total grower revenue decreases to an estimated $150 million, a decrease of $1 million.

Sensitivity Analysis

Analysis of the shortrun economic effects of a suspension depend critically on the values for the free market processing-use percentage and the price flexibilities, especially the price flexibility for fresh navels. Several combinations of values for the processing-use percentage and for fresh navel

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[21] These findings are based on a price flexibility for fresh navel oranges of -1.9 and a processing-use percentage of 18 percent.

[22] These findings are based on a price flexibility for fresh navel oranges of -2.23 and a processing-use percentage of 20 percent.

[23] These findings are based on a price flexibility for fresh navels of -1.37 and a processing-use percentage of 15 percent.

Table 11—Grower revenue, prices, and use of C-A navels with and without a prorate in a normal-supply season

Item	Actual, with prorate 1/	Estimated, without prorate 2/
	Carloads 3/	
Use:		
Fresh domestic	43,384	
Fresh export	5,537	
Total fresh	48,921	4/ 56,615
Products	20,523	5/ 12,829
Other	1,828	1,828
Total, all uses	71,272	71,272
	Dollars per box, on-tree equiv. 3/	
Prices:		
Fresh	5.24	6/ 3.96
Products	-.85	7/ -.85
Grower average	8/ 3.44	8/ 3.08
	1,000 dollars	
Gross revenues:		
Fresh	128,173	112,238
Products	-8,722	-5,452
Total	8/ 119,451	8/ 106,785

1/ Average during 1979/80-1983/84 seasons.

2/ Based on average fresh price flexibility of -1.9 and a free-market processing use of 18 percent.

3/ Box = 75 lbs., carload = 1,000 cartons, carton = 37 1/2 lbs.

4/ Actual fresh shipments plus 7,694 carloads of actual products diverted to fresh.

5/ Eighteen percent of total shipments.

6/ Estimated as P[(K + 2)/(2 - K)], where P = actual price, and K = (price flexibility)*(average percent change in total fresh). This mathematical formulation was derived from an arc price flexibility.

7/ Based on an assumption of a zero price flexibility for navel oranges used in products.

8/ Does not include returns to "other" uses.

price flexibilities were selected to evaluate the sensitivity of the estimated effects with a suspension.

In a small-supply season, price flexibilities for fresh navel oranges of -1.11 and -1.63 were selected as alternative values to -1.37, the most likely value. Price flexibilities for fresh navels of -1.64 and -2.16 were

Table 12--Grower revenue, prices, and use of C-A navel oranges with and without a prorate in a large-supply season

Item	Actual, with prorate 1/	Estimated, without prorate 2/
	Carloads 3/	
Uses:		
Fresh domestic	49,018	
Fresh export	6,851	
Total fresh	55,869	4/ 65,189
Products	26,155	5/ 16,835
Other	2,151	2,151
Total, all uses	84,175	84,175
	Dollars per box, on-tree equiv. 3/	
Prices:		
Fresh	4.58	6/ 3.24
Products	-.46	7/ -.46
Grower average	8/ 2.97	8/ 2.48
	1,000 dollars	
Gross revenue:		
Fresh	127,940	105,535
Products	-6,016	-3,872
Total	8/ 121,924	8/ 101,663

1/ Season average during 1982/83.

2/ Based on average fresh price flexibility of -2.23 and a free-market processing use of 20 percent.

3/ Box = 75 lbs., carload = 1,000 cartons, carton = 37 1/2 lbs.

4/ Actual fresh shipments plus 9,320 cars of actual products diverted from fresh.

5/ Twenty percent of shipments.

6/ Estimated as P[(K + 2)/(2 - K)] where P = actual price, and K = (price flexibility)*(average percent change in total fresh). This mathematical formulation was derived from an arc price flexibility.

7/ Based on an assumption of a zero price flexibility for navel oranges used in products.

8/ Does not include returns to "other" uses.

selected as alternatives to -1.9, the most likely value in a normal-supply season. Price flexibilities for fresh navel oranges of -1.97 and -2.49 were selected as alternative values to -2.23, the most likely value in a large-supply season. Two additional processing-use percentages were selected, 3 percentage points above and below the most likely levels selected for the small- and normal-supply seasons. Processing-use percentages were set 4 percentage points above and below the most likely levels selected for the large-supply season.

Table 13--Grower revenue, prices, and use of C-A navels with and without a prorate in a small-supply season

Item	Actual, with prorate 1/	Estimated, without prorate 2/
	Carloads 3/	
Uses:		
Fresh domestic	38,274	
Fresh export	5,115	
Total fresh	43,389	4/ 45,861
Products	10,794	5/ 8,322
Other	1,295	1,295
Total, all uses	55,478	55,478
	Dollars per box, on-tree equiv. 3/	
Prices:		
Fresh	7.24	6/ 6.71
Products	-1.04	7/ -1.04
Grower average	8/ 5.59	8/ 5.52
	1,000 dollars	
Gross revenue:		
Fresh	157,068	153,878
Products	-5,613	-4,327
Total	8/ 151,455	8/ 149,551

1/ Season average during 1981/82.

2/ Based on average fresh price flexibility of -1.37 and a free-market processing use of 15 percent.

3/ Box = 75 lbs., carload = 1,000 cartons, carton = 37 1/2 lbs.

4/ Actual fresh shipments plus 2,472 cars of actual products diverted to fresh.

5/ Fifteen percent of total shipments.

6/ Estimated as P[(K + 2)/(2 - K)] where P = actual price, and K = (price flexibility)*(average percent change in total fresh). This mathematical formulation was derived an arc price flexibility.

7/ Based on an assumption of a zero price flexibility for navels used in products.

8/ Does not include returns to "other" uses.

Estimated grower revenue effects of a suspension were more sensitive to changes in the price flexibility for fresh navels than to changes in the processing-use percentage. In a normal-supply season where 18 percent of the crop is considered not fresh-marketable and with a fresh-market price flexibility of -2.16, estimated total grower revenue decreases by about $16.9 million, or about 14 percent (table 14). Total grower revenue is estimated to decline $12.7 million, or about 11 percent, with a fresh price flexibility of -1.9 and $8.2 million, or about 7 percent, with a fresh price flexibility of -1.64.

Changing processing-use percentages have less effect on grower revenue than changing price flexibilities. Grower revenue is estimated to decrease by $15.6 million in a normal-supply season when the processing-use percentage is 15 percent and the fresh-market price flexibility is 1.9.

Grower revenue declines about $12.7 million with an 18-percent processing-use percentage, and about $9.5 million with a 21-percent processing-use percentage. Similar results are obtained for the small- and large-supply seasons. Effects of different price flexibilities and processing-use percentages on grower revenue are illustrated in tables 15 and 16.

Table 14—Estimated within-season revenue reduction from prorate suspension for alternative fresh price flexibilities and processing use percentages in a normal-supply season 1/

Free-market processing-use percentage	Fresh price flexibility		
	-1.64	-1.9	-2.16
		1,000 dollars	
15	-10,161 2/(-8.5)	-15,578 (-13.0)	-20,780 (-17.4)
18	-8,254 (-6.9)	-12,665 (-10.6)	-16,932 (-14.2)
21	-6,200 (-5.2)	-9,526 (-8.0)	-12,768 (-10.7)

1/ Normal-crop season based on five-season average production, prices, and use during 1979/80-1983/84.

2/ Numbers in parentheses are percentage changes from actual revenue during 1979/80-1983/84 seasons.

Shortrun total grower revenue effects of a prorate suspencion that are considered most likely range from those values in the upper left corners of tables 14-16 to the values in the lower right corners.24/ For the

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24/ The reason for this is that smaller processing-use percentages are associated with larger absolute fresh-market price flexibilities and larger processing-use percentages are associated with smaller absolute fresh-market price flexibilities. With larger absolute price flexibilities, prices decline relatively more and a smaller share of the small and lower grade navels are therefore fresh-marketable. Conversely, with smaller absolute price flexibilities, prices decline relatively less and a larger share of the smaller and lower grade navels are fresh-marketable.

Table 15—Estimated within-season gross revenue reduction from prorate suspension for alternative fresh price flexibilities and processing-use percentages in a large-supply season 1/

Free-market processing-use percentage	Fresh price flexibility		
	-1.97	-2.23	-2.49
		1,000 dollars	
16	-20,550 2/ (-16.9)	-26,197 (-21.5)	-31,606 (-25.9)
20	-15,833 (-13.0)	-20,261 (-16.6)	-24,542 (-20.1)
24	-10,656 (-8.7)	-13,699 (-11.2)	-16,671 (-13.7)

1/ Based on 1982/83 production, prices, and use.

2/ Numbers in parentheses are percentage changes from actual during the 1982/83 season.

Table 16--Estimated within-season gross revenue reduction from prorate suspension for alternative fresh price flexibilities and processing-use percentages in a small-supply season 1/

Free-market processing-use percentage	Fresh price flexibility		
	-1.11	-1.37	-1.63
		1,000 dollars	
12	583 2/(0.4)	-3,064 (-2.0)	-6,632 (-4.4)
15	330 (0.2)	-1,905 (-1.3)	-4,109 (-2.7)
18	102 (0.1)	-649 (-0.4)	-1,395 (-0.9)

1/ Based on 1981/82 production, prices, and use.

2/ Numbers in parentheses are percentage changes from actual during the 1981/82 season.

normal-supply season, the most likely range of shortrun total grower revenue effects from a suspension is an estimated decrease between 8.5 and 10.7 percent. For the large-supply season, the most likely range of shortrun total grower revenue effects due to a suspension is an estimated decrease between 13.7 and 16.9 percent. In a small-supply season, the most likely range of shortrun total grower revenue effects from a suspension is an estimated decrease of 1.3 percent to an increase of 0.4 percent.[25]

Consumer Price and Consumption Effects

If changes in grower prices with a suspension are transmitted through the marketing channel to the retail level, consumers would pay less for fresh navel oranges and consume slightly more. Retail expenditures by domestic (U.S. and Canada) consumers would fall an estimated $12.5 million for fresh navels, or about 5 cents per capita, with a suspension during a normal-supply season (table 17). Per capita fresh navel consumption would rise 1.13 pounds from 6.42 to 7.55.

Reduction of consumer expenditures from a suspension is greater during a large-supply season and less during a small-supply season. Total retail expenditures would have fallen about $17.7 million with a suspension during the 1982/83 season, but only about $1.8 million during the 1981/82 season. Similarly, per capita consumption of fresh navels would have increased about 1.36 pounds with a suspension during the 1982/83 season, but only 0.63 pounds during 1981/82. Consumer expenditure effects for consumption of fresh navels are slightly less than the grower income effects since changes in expenditures in the export and processing markets also affect grower income.

Grower and Consumer Welfare Effects

Of interest when evaluating the effects of a suspension are shortrun changes in the economic welfare of growers and consumers. For growers this can be defined as adjustments in the economic rent associated with fixed factors of production. Economic rent is a measure of the returns beyond those minimally needed to retain fixed investments in production such as navel groves and land. Change in economic rent in the short run with a fixed (that is, perfectly inelastic) supply equals change in grower revenues. Shortrun economic rents are estimated to decline with a suspension by about $12.7 million in the normal-supply season, $20.3 million in the large-supply season, and $1.9 million in the small-supply season (table 18).

Consumer surplus, a measure of consumer well-being, is the difference between what consumers actually pay for a commodity and the maximum price they would be willing to pay. If some consumers purchase the commodity at a lower price than the maximum they are willing to pay, they realize a consumer surplus. If changes in grower prices are fully transmitted through the marketing channel to the retail level, consumer surplus in the domestic fresh market with a

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[25] During a small-supply season and with relatively small absolute values of the price flexibility for fresh navel oranges, estimated grower revenue increased with a suspension. This means that in a small-supply season, NOAC could possibly increase grower revenue by allowing a greater share of the navel orange crop into the fresh market.

Table 17—Estimated within-season effects of C-A navel orange suspension on consumer expenditures and per capita consumption

Item	Supply size 1/		
	Small	Normal	Large
Changes in consumer expenditures for navel oranges:		1,000 dollars	
Fresh domestic	-1,849	-12,532	-17,744
		Cents per capita	
Per consumer	-0.7	-5	-7
Per capita consumption of navel oranges:		Pounds per capita	
Fresh domestic with a prorate	5.66	6.42	7.18
Fresh domestic with a suspension	6.02	7.55	8.54

1/ The numbers appearing in the cells for the small-supply season were generated from table 13, normal-supply season from table 11, and large-supply season from table 12.

Table 18--Estimated within-season grower and consumer welfare effects of C-A navel orange suspension

Item	Supply size 1/		
	Small	Normal	Large
Changes in economic surplus:		1,000 dollars	
Consumers	10,470	30,228	35,964
Grower economic rent	-1,904	-12,666	-20,261
Net social welfare	8,566	17,562	15,703
		Cents per capita	
Per capita net social welfare gain	3.3	6.9	6.1

1/ Numbers appearing in the cells for the small-supply season were generated from table 13, normal-supply season from table 11, and large-supply season from table 12.

suspension is estimated to be greater by about $30.2 million in the normal-supply season, $35.9 million in the large-supply season, and $10.5 million in the small-supply season.26/

Net social economic welfare is defined as the sum of consumer surplus and grower economic rents. Estimated shortrun gains in consumer surplus exceed the losses in grower economic rents for all crop sizes considered. Net social welfare would have been greater with a suspension by about $17.6 million in the normal-supply season, $15.7 million in the large-supply season, and $8.6 million in the small-supply season.

The average welfare gain with a suspension would have been about 7 cents per capita in the normal-supply season, 6 cents per capita in the large-supply season, and 3 cents per capita in the small-supply season. The average consumer surplus gain would have been about 12 cents per capita in the normal-supply season, 14 cents per capita in the large-supply season, and 4 cents per capita in the small-supply season. Economic rent per grower would have decreased about $3,159 in the normal-supply season, $4,912 in the large-supply season, and $478 in the small-supply season.

The preceding net social welfare measures do not account for the increase in consumer welfare in the export market; that is, foreign consumers may also realize increased consumer surplus. Also, the welfare measures are based on a partial market analysis and, thus, do not measure the producer and consumer welfare implications of a suspension on the Florida and Texas orange markets and on other competing fruit markets. And, the longrun welfare implications of a suspension may be different from those for the short run.

Longrun Economic Effects of a Suspension

Information is not available to adequately estimate the production adjustment likely to occur with a longrun continuation of a suspension.27/ Therefore,

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26/ Changes in consumer surplus were based on the assumption of a linear retail demand within the relevant range of price change and on changes in price at the retail level equaling change in grower price. The consumer surplus measures could be different if these conditions do not hold. The formula used to calculate the change in consumer surplus is:

$$CS = (P_p - P_s)*Q_p^{fd} + (1/2)*(P_p - P_s)*(Q_s^{fd} - Q_p^{fd}).$$

Definitions:

CS = Change in consumer surplus in the fresh domestic market.

P_p = Grower price for fresh navels with a prorate.

P_s = Grower price for fresh navels with a suspension.

Q_p^{fd} = Fresh domestic shipments with a prorate.

Q_s^{fd} = Fresh domestic shipments with a suspension.

27/ The long run is the period of time required for growers to make adjustments in fixed inputs, namely navel orange groves. The long run for acreage expansion is typically defined in terms of the gestation period (5-7 years) for navel orange groves. The long run for acreage removal can vary from several years to more than 20 years.

the longrun effects of a suspension are discussed in terms of direction of change rather than as an absolute amount of change. The discussion draws heavily on theoretical results from Heifner et al and empirical research by Thor and Jesse.28/

Growers would reduce navel orange grove acreage in response to decreased shortrun grower returns under a suspension. Longrun grower returns would be no greater and perhaps less than with the prorate. Grower weighted average price would be no greater with a continuation of the suspension than with a prorate, and may be less.

The longrun price for fresh navels would probably be less with a suspension than with prorate. The exact magnitude of any decline in fresh prices depends on the increase in fresh uses. While processing use of navels would decline, the longrun price for processing navels would probably not change. Processing navel prices are determined mostly by the price of Florida and Brazilian frozen concentrated orange juice.

Major longrun effects of a continuation of a suspension would be a decrease in production and processing uses. Growers who are least efficient, highly financially leveraged, or both would most likely reduce navel acreage. Because of smaller processing use under a continuation of the suspension, citrus processing facilities would probably be underutilized. Some citrus facilities may be shut down or converted to other processing.

CONCLUSIONS

The market for C-A navels performed in about the same way during the 1984/85 season after the prorate was suspended as during comparable prorated periods. There were only minor differences between the prorate suspension and prorate periods in stability of shipments and prices. Higher prices during the 1984/85 season were mostly due to relatively small U.S. fresh orange supplies during the winter. Handler marketing practices appeared to change very little during the partial season with a suspension. The prorate helps to elevate grower revenue in the short run by diverting some fresh navels from the fresh market into processing. Consequently, prices for fresh-marketable navel oranges are higher than they would be without a prorate, and a larger share of the navel crop enters processing. Magnitude of these effects tends to be greater during seasons with larger navel supplies.

A suspension of the handler prorate could result in a number of shortrun gains and losses among consumers, processors, and growers. Shortrun increases in shipments to the fresh market could result in lower retail prices for fresh navels if lower grower prices were passed on through the marketing channel. Consumption of fresh navels would increase. C-A citrus processors could lose as their costs would rise and revenues fall as smaller quantities of navels enter processing. Lower prices for fresh navels, however, mean lower grower revenue.

28/ R. Heifner, W. Armbruster, E.V. Jesse, G. Nelson, and C. Shafer. A Review of Federal Marketing Orders for Fruits, Vegetables, and Specialty Crops, Agr. Mktg. Serv., U.S. Dept. Agr., AER-477, Nov. 1981; op.cit.

The prorate provides each handler equal access (in proportion to total shipments) to ship into the fresh domestic market. A prorate suspension would result in greater marketing freedom among handlers. Thus, handlers who have higher quality navels or superior marketing abilities may gain if they can sell a larger share of their navels into the fresh markets than other handlers.

Fresh orange producers in Florida and Texas also could incur shortrun revenue losses from a prorate suspension. Increased supplies of fresh C-A navels could lead to some substitution from Florida and Texas produced oranges to C-A navels among consumers. Prices and revenue for Florida and Texas fresh oranges would likely decline some. Increased supplies of fresh C-A navels could decrease the prices for competing fresh fruits such as apples, grapefruit, and bananas.

APPENDIX: NAVEL ORANGE PRICE FLEXIBILITIES

Price flexibilities are a measure of responsiveness of the market price of a commodity to a change in the quantity of the commodity marketed. Price flexibilities measure the percentage change in the market price associated with a 1-percent change in the quantity marketed. Thus, a price flexibility of -1.5 means that a 1-percent increase in the quantity marketed will decrease the market price by 1.5 percent. The larger the absolute value of the price flexibility, the larger is the change in price associated with a 1-percent change in the quantity marketed. A price flexibility of zero means that the market price is not affected by increases in the quantity marketed. Price flexibilities used in this study were derived from market price equations for California fresh and processing navel oranges.

Fresh Navel Orange Prices

The annual price for fresh California navel oranges is specified as a function of consumption of California fresh navel oranges (including the United States and Canada), consumption of substitute commodities (Florida early, mid-season, and navel oranges, Texas oranges, grapefruit, bananas, and apples), disposable income, and unexpected changes in the crop sizes for Florida early, mid-season, and navel, and California navel oranges.[1] The price for fresh California navel oranges and disposable income were expressed in real terms. To minimize problems of multicollinearity, disposable income and consumption were expressed on a per capita basis. Preliminary analysis revealed that the effects of per capita consumption of grapefruit, bananas, apples, Texas oranges, and disposable income on the price for fresh navel oranges were not significantly different from zero and, thus, they were excluded from the final specification. The exclusion of these variables from the price equation did not have any pronounced effect on the magnitude of the estimated coefficient for per capita consumption of California fresh navel oranges.

A semi-log functional form was used. The estimated coefficients and the corresponding standard errors for the independent variables in the market price equation for fresh navel oranges are:

$$\begin{array}{llllll} \text{(1)} \quad \text{CFNPD} = & 5.42 & - \; 1.71{*}\text{CFNDS} & - \; 0.41{*}\text{FTQ} & + \; 0.71{*}\text{F1} & - \; 1.17{*}\text{C2} \\ & (0.36){*} & (0.13){*} & (0.11){*} & (0.32){*} & (0.50){*} \end{array}$$

$$R^2 = 0.94 \qquad \text{D.W.} = 1.87$$

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[1] The United States and Canada are combined into one market to maintain consistency with the fresh domestic market as defined in the Federal marketing order for C-A navel oranges. Also, fresh domestic navel orange shipment data cannot be accurately delineated between the United States and Canada.

An asterisk (*) by the standard error indicates that the coefficient for the independent variable is significantly different from zero at the 5-percent level.2/

Definition of variables:

CFNPD = The seasonal weighted average e.o.t. price for California fresh navel oranges (deflated by the Consumer Price Index for all goods, 1967 = 100, $/carton).

CFNDS = The log of per capita consumption of California fresh navel oranges, includes the United States and Canada (fresh weight, lbs./capita).

FTQ = The log of per capita consumption of Florida early, mid-season, and navel oranges, includes the United States and Canada (fresh weight, lbs./capita).

F1 = The log of the ratio of the pre-season (October) USDA estimate of Florida early, mid-season, and navel orange crop size to actual crop size.

C2 = The log of the ratio of the mid-season (February) USDA estimate of California navel orange crop size to actual crop size.

Annual data were for 1962/63-1983/84.3/ The value of the Durbin-Watson test statistic indicates the absence of a first-order auto-correlation process among the residual terms. The estimated coefficients for all independent variables are significantly different from zero.

The negative coefficient for per capita consumption of fresh navel oranges means that fresh navel orange prices decline with increased supplies to the fresh domestic market.

Likewise, the negative coefficient for FTQ implies that increased supplies of Florida early, mid-season, and navel oranges also tend to decrease the price for California fresh navel oranges.

An unexpected decrease in the actual crop size of Florida early, mid-season, and navel oranges from the pre-season (October) estimate is found to increase the price for fresh navels. This means that an unexpected reduction in the Florida crop due to freeze damage increases the price for fresh navels.

An unexpected decrease in the actual crop size of California navels from the mid-season (February) estimate reduces the price for fresh navels. An unexpected decrease in the crop size may be caused by adverse weather lowering the quality of the oranges. Theoretically, an unexpected decrease in size can have a positive effect on price, while lower fruit quality is expected to have a negative effect on price. These two effects move in opposite directions and, as indicated by the negative coefficient, the magnitude of the quantity effect is overwhelmed by the quality effect.

The price flexibilities for fresh navel oranges during the small-supply season (1981/82) and large-supply season (1982/83), along with the normal-supply season (1979/80 to 1983/84) were computed using the predicted prices for the

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2/ Least squares was used to estimate equation (1). Because of the possible simultaneity between fresh navel orange price and per capita consumption of fresh navels, the estimated coefficient for per capita consumption may be slightly biased.

3/ Annual data for 1984/85 were not available when the analysis was conducted.

respective season and the actual per capita consumption of fresh navel oranges.[4/] Confidence intervals for the price flexibilities, equal to two standard deviations about the the computed value, were calculated.[5/] In the small-supply season, the confidence interval for the price flexibility is -1.11 to -1.63, with -1.37 as the computed value. In the normal-supply season, the confidence interval for the price flexibility is -1.64 to -2.16, with -1.90 as the computed value. And, in the large-supply season, the confidence interval for the price flexibility is -1.97 to -2.49, with -2.23 as the computed value.

Processing Navel Orange Prices

The annual price for California processing navel oranges is hypothesized to be primarily a function of their juice value along with per capita disposable income in the United States and Canada, per capita consumption of California processing navel oranges, and unexpected changes in the crop size for Florida early, mid-season, and navel and California navel oranges during the season. Prices and income were expressed in real terms. To minimize problems of multicollinearity, disposable income and consumption were expressed on a per capita basis. Because C-A processing navel oranges constitute such a small share of the total frozen concentrated orange juice market, they can be considered as "price-takers." However, the relationship between frozen concentrated orange juice prices and processing prices of California navel oranges is not expected to be exact because the juice from navels is inferior (lower quality) to that of Florida and Brazilian oranges. The amount of California navel oranges processed and unexpected changes in the crop size of California navel oranges were found not to significantly affect the price for California processing navel oranges.

Estimated coefficients and standard errors for the independent variables in the market price equation for California processing navels are:

$$(2)\quad \text{CPNPD} = \underset{(0.46)}{0.31} + \underset{(0.086)^*}{0.32}{*}\text{FCOJP} - \underset{(0.11)^*}{0.46}{*}\text{INC} + \underset{(0.20)^*}{0.44}{*}\text{F1} + \underset{(0.03)}{0.03}{*}\text{CNPS}$$

$$R^2 = 0.84 \qquad\qquad \text{D.W.} = 1.60$$

An asterisk by the standard error (*) indicates that the estimated coefficient for the independent variable is significantly different from zero at the 5-percent level.

Definition of variables:

CPNPD = Seasonal weighted average e.o.t. price for California processing navel oranges (deflated by the Consumer Price Index for all goods, 1967 = 100, $/carton).

[4/] For equation (1), the price flexibility equals the estimated coefficient for per capita consumption of fresh navel oranges multiplied by the inverse of the predicted fresh navel orange price.

[5/] The standard deviation of the estimated coefficient for per capita consumption of fresh navels from equation (1) was multiplied by two and then added and subtracted from the computed price flexibility to form a confidence interval for the price flexibility.

FCOJP = Seasonal weighted average f.o.b. price per dozen 6-ounce cans of frozen concentrated orange juice (deflated by the Consumer Price Index for all goods, 1967 = 100, $/carton).

INC = Per capita disposable income for the United States and Canada. Canadian income is adjusted by U.S.-Canadian exchange rate, (deflated by the Consumer Price Index for all goods, 1967 = 100, $1,000 per capita).

F1 = Ratio of the pre-season (October) estimate of Florida early, mid-season, and navel orange crop size to actual crop size.

CNPS = Per capita consumption of California processing navel oranges includes the United States and Canada (fresh weight, lbs./capita).

Annual data were for 1962/63 to 1983/84. The value of the Durbin-Watson test statistic indicates the absence of a first-order auto-correlation process among the residual terms.

Except for the estimated coefficient for per capita consumption of California processing navel oranges, the estimated coefficient for each independent variable is significantly different from zero.

As indicated by the estimated coefficient for the price of frozen concentrated orange juice, an increase in the real frozen concentrated orange juice price causes the price of California processing navels to increase.

Increases in per capita real disposable income decrease the real price of processing navel oranges. As income increases there may be some substitution of frozen concentrated orange juice made from California navel oranges with other commodities.

Freeze damage to the Florida crop during the marketing season increases the real price for processing navel oranges in two ways. First, the total supply of oranges is reduced. Second, the adjustment to the reduced supply must be made during the remaining portion of the season rather than over the entire season. Both effects tend to increase market prices.

The effect on the price for California processing navels from changes in the per capita consumption of processing navels is small and not significantly different from zero. Consequently, the computed price flexibility for processing navels was approximately equal to zero.

Appendix table 1--Statistical comparison of mean and variance of C-A navel orange prices during the 1984/85 prorate suspension, and the comparable 1979/80 to 1983/84 prorated period 1/

Price series, use, grade, and fruit size	Deflated price 2/	
	Mean test	Variance test
	t - value	F - value
New York City, wholesale, fresh, first, 48-113: 3/		2.98 (P,50,11)*
Chicago, wholesale, fresh, first: 4/		
56		5.92 (P,82,11)*
72	2.44 (S,96)*	2.26 (P,85,11)
88	3.60 (S,98)*	2.05 (P,87,11)
113	4.04 (S,79)*	2.11 (P,68,11)
Los Angeles, wholesale, fresh, first, 56-113: 5/		4.17 (P,46,10)*
Central California, f.o.b., fresh, first:		
56	5.93 (S,85)*	1.44 (P,74,11)
72	10.22 (S,85)*	2.52 (P,74,11)
88		2.61 (S,11,74)*
113	7.65 (S,85)*	1.90 (S,11,74)
138	6.53 (S,85)*	1.49 (P,74,11)
Southern California, f.o.b., fresh, first:		
56		4.73 (P,37,7)*
72		4.94 (P,37,7)*
88		61.15 (P,37,7)*
113		7.62 (P,37,7)*
138		5.49 (P,37,7)*
Central California, f.o.b., fresh, choice:		
56	4.97 (S,94)*	1.80 (S,12,82)
72		2.99 (S,11,82)*
88	7.16 (S,94)*	3.50 (S,12,82)
113		3.00 (S,12,80)*
138	5.20 (S,86)*	1.24 (S,12,74)
Southern California, f.o.b., fresh, choice:		
56	1.10 (S,32)	58.58 (P,25,7)*
72	2.31 (S,32)*	2.46 (P,25,7)
88		3.43 (P,25,7)*
113		3.55 (P,25,7)*
138		4.58 (P,25,7)*

1/ The midweek prices were from February 7 (effective start of the prorate suspension) to the end of the season. Wholesale prices were deflated by the wholesale price index for fresh fruits, 1977 = 100. F.o.b. prices were deflated by the index of prices received by farmers for all farm commodities, 1977 = 100.

2/ The "P" or "S" indicates whether average prices or variance of price during the respective prorated or prorate suspension periods were greater. An asterisk ("*") with a "P" or "S" indicates whether average prices or variance of price during the prorated or prorate suspension periods, respectively, were significantly greater at the 5-percent level. The number(s) within the parentheses is (are) the degrees of freedom. Mean test results were not calculated for those cases where the variance between the two periods were significantly different. No standard mean test is available for those cases when the variances between the two periods were different.

3/ New York City wholesale prices were available only during 1981/82-1984/85.

4/ Chicago wholesale price (113) were available only during 1979/80 and 1981/82-1984/85.

5/ Los Angeles wholesale prices were available only during 1981/82-1984/85.

Source: Federal-State Market News Service, U.S. Dept. of Agr.

Appendix table 2—Statistical comparison of mean and variance of C-A navel orange prices during the 1984/85 prorate suspension, and the comparable 1981/82 prorated period 1/

Price series, use, grade, and fruit size	Deflated price 2/	
	Mean test	Variance test
	t - value	F - value
Central California, f.o.b., fresh, first:		
56		74.30 (S,11,11)*
72		8.47 (S,11,11)*
88		23.66 (S,11,11)*
113		184.00 (S,11,11)*
138		542.00 (S,11,11)*

1/Midweek prices from February 7 (effective start of prorate suspension) to the end of the season. Prices are deflated by the index of prices received by farmers for all farm commodities, 1977 = 100.

2/ The "P" or "S" indicates whether prices or variance of price during the respective prorated or prorate suspension periods were greater. An asterisk ("*") with a "P" or "S" indicates whether prices or variance of price during the prorated or prorate suspension periods, respectively, were significantly greater at the 5-percent level. The number(s) within the parentheses is (are) the degrees of freedom. Mean test results are not calculated for those cases where the variance between the two periods were significantly different. No standard accepted mean test is available in those cases when the variances between the two periods are different.

Source: Federal-State Market News Service, U..S. Dept. of Agr.

UNITED STATES DEPARTMENT OF AGRICULTURE
ECONOMIC RESEARCH SERVICE
1301 NEW YORK AVENUE, N. W.
WASHINGTON, D. C. 20005-4788

Mr. LYNCH. So, in future marketing orders, just to understand your earlier testimony, marketing orders from henceforth will go through the regulatory flexibility process?

Mr. HANDLEY. What I have agreed to with SBA, specifically Mr. Cadwell, is to look at examples of guidelines developed by other agencies used in the development of regulatory flexibility analyses.

We have agreed that we will take a look at those guidelines, and study the idea of the applicability. Of course, we agree that regulatory flexibility does apply to marketing orders; but the feasibility of setting up guidelines for 40-some marketing orders affecting 35 different commodities must be studied further. All these commodities have very different circumstances under which they are produced and marketed, and they affect very different geographical areas.

We just have a lot of details that we have to take a look at.

We are willing to do that, and we will keep this subcommittee informed as to our progress.

Mr. LYNCH. One final question on the milk case that was cited.

Is the issue in that case, the certification issue—in other words, was it certified that it did not have an impact on a substantial number of small entities?

Mr. HANDLEY. Could I ask Mr. Golden to respond to that?

Mr. LYNCH. Sure.

Mr. GOLDEN. Yes.

Mr. LYNCH. What is the Department's stand? Do you feel that is reviewable by the court, or what is your stand on that certification question? What is going to be the response?

Mr. GOLDEN. If you would like, we could provide you with a copy of our brief, which we filed in that case, which lays that issue out. We have taken the position that it is not reviewable.

Mr. LYNCH. By the court—we would like that for the record.

Mr. GOLDEN. Certainly.

Mr. LYNCH. Thank you.

That is all the questions that I have.

[The brief referred to follows:]

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LEHIGH VALLEY FARMS, *et* al., Plaintiffs v. JOHN R. BLOCK, Secretary of Agriculture, United States Department of Agriculture, Defendant	Civil Action No. CA 85-6422
and FARMERS' COOPERATIVE DAIRY, INC., *et* *al*., Plaintiffs v. JOHN R. BLOCK, Secretary of Agriculture, United States Department of Agriculture, Defendant	Civil Action No. CA 85-6484

Defendant's Response To Motion For Leave To Intervene As An Amicus Curiae By The Chief Counsel For Advocacy

On March 3, 1986, the Chief Counsel for Advocacy of the Small Business Administration moved to intervene as an amicus curiae in the above-captioned actions and filed an amicus curiae brief.

Defendant, by his undersigned attorneys, hereby responds to said motion and brief and moves this Court to deny said motion for intervention. If for some reason intervention is granted, defendant moves that this Court enter summary judgment in his favor on these issues in both of the above-captioned actions pursuant to Rule 56 of the Federal Rules of Civil Procedure on the ground that there is no genuine issue as to any material fact and that the defendant is entitled to judgment as a matter of law.

In support of these motions, defendant refers the Court to his memorandum of points and authorities filed herewith.

Respectfully submitted,

GREGORY COOPER
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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LEHIGH VALLEY FARMS, *et* al.,

Plaintiffs

v.

JOHN R. BLOCK, Secretary of
Agriculture, United States
Department of Agriculture,

Defendant

Civil Action No. CA 85-6422

and

FARMERS' COOPERATIVE DAIRY, INC.,
et al.,

Plaintiffs

v.

JOHN R. BLOCK, Secretary of
Agriculture, United States
Department of Agriculture,

Defendant

Civil Action No. CA 85-6484

Defendant's Memorandum Of Points And Authorities In Support Of Defendant's Response To Motion For Leave To Intervene As An Amicus Curiae By The Chief Counsel For Advocacy

I. Preliminary Statement

On March 3, 1986, the Chief Counsel for Advocacy of the Small Business Administration moved to intervene as an amicus curiae in the above-captioned actions and filed an amicus curiae brief. The prospective intervenor based his request on the assertion that compliance with the Regulatory Flexibility Act is "one issue raised" in these actions. A review of the complaints filed by the plaintiffs in these actions, however, fails to demonstrate that this question of compliance was ever raised. Defendant believes that such a new issue should not be allowed at this late date since it merely serves to delay a ruling on the merits during a period when the decision of the Secretary has been preliminarily enjoined.

Defendant believes there is no basis in law to even allow the intervention sought and has requested it be denied. If the intervention be granted, defendant believes nonetheless, on the basis of the applicable legal principles and the record evidence that defendant is entitled to summary judgment on this issue.

II. Intervention

Under Rule 24 of the Federal Rules of Civil Procedure, there are several grounds for intervention. One of these grounds, for both intervention of right and permissive intervention, is that a statute of the United States confers a right to intervene. This is the only ground asserted by the prospective intervenor. The claim is made that the right to intervene is conferred by section 612 of the Regulatory Flexibility Act (5 U.S.C. 612), hereinafter the "RFA", though there is no mention as to whether this right is unconditional (intervention of right) or conditional (permissive intervention).

Section 612(b) of the RFA states that the prospective intervenor is authorized to appear as amicus curiae in any action brought in a court of the United States to review a rule. However, said section expressly limits this authorization. The prospective intervenor is only authorized:

> . . . to present his views with respect to the effect of the rule on small entities.

Section 612(c) of the RFA directs the courts only to allow such intervention for the above-quoted purpose.

In the instant action, the prospective intervenor does not attempt to present his views on the effect of the rule. His motion clearly states he is seeking intervention to challenge defendant's alleged "failure to comply" with the RFA. (Motion, paragraph 5) If the prospective intervenor were here for a proper purpose, one might expect to find in his amicus curiae brief factual input on the effect of the amendments on small business. Yet, in 18 pages of brief, one finds no specific economic facts except perhaps only three citations to parts of the Secretary's Decision. Instead, the amicus curiae brief is replete with legal argument and generalized conclusory statements that indicate a misapprehension of the formal rulemaking process conducted under the Agricultural Marketing Agreement Act of 1937, amended (7 U.S.C. 601-674), a lack of any review of the evidence in the rulemaking record, and a shocking misunderstanding of the legal requirements of the RFA.

Since the only ground for intervention is statutorily limited to a proper specified purpose (i.e., the presentation of informed views on economic effects), and since the intervention sought is clearly not related to the statutorily authorized purpose, there is no ground for intervention, whether permissive or of right, and prospective intervenor's motion for leave to intervene should be denied.

III. Requirements Under The RFA

The RFA is designed to encourage agencies in the course of their rulemaking to consider the effects of their regulations on small entities. It is particularly well suited for informal rulemaking where an agency merely publishes its proposed rule and asks for written comments in a limited time frame. It is perhaps not so well designed for formal rulemaking as conducted under the Agricultural Marketing Agreement Act where the agency publishes a proponent's proposal (rather than an agency proposal), the proponent bears the burden of introducing the supporting evidence, the opponents bear the burden of introducing contrary evidence, and the agency makes a decision on the basis of the introduced evidence. However, the spirit of the RFA is complied with since any person (and almost all the handlers and producers involved in the instant case are small entities) has ample opportunity to testify, offer exhibits, and cross examine. Unlike most agency informal rulemaking documents, the recommended decision and the decision of the Department are long, detailed analysis of the economics of the rule in line with the essential aims of 5 U.S.C. 605(a). Whether the RFA is meant to apply at all to formal rulemaking[1] is an interesting question, but not one we need address in the instant case.

Assuming, arguendo, that the RFA applies to the instant formal rulemaking proceeding, it requires the agency to choose either of two options: (1) To certify that the rule will not have a significant economic impact on a substantial number of small entities (5 U.S.C. 605(b)); or (2) To do a detailed regulatory flexibility analysis (5 U.S.C. 603 and 604). The choice between these two options is left to the complete discretion of the agency, and not the prospective intervenor.

In the instant case, the agency chose the first option: the certification that the rule would not have a significant economic impact on a substantial number of small entities. Neither the prospective intervenor, nor any other party, disputes that the agency made this certification in a proper technical manner. What is claimed, however, is that the agency certification is factually incorrect. Such a challenge must fail since the certification: (a) is not subject to judicial review; and (b) is factually correct.

(a) Judicial Review. Section 611 of the RFA clearly provides, in relevant part, that:

> (a) Except as otherwise provided in subsection (b), any determination by an agency concerning the applicability

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[1] See, e.g., O'Reilly, Administrative Rulemaking, p. 196 (1983); Verkuil, A Critical Guide to the Regulatory Flexibility Act, 1982 Duke L.J. 229 (1982).

> of any of the provisions of this chapter to any action of the agency shall not be subject to judicial review.
>
> (b) Any regulatory flexibility analysis prepared under sections 603 and 604 of this title and the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review. When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review.

The express language of the RFA, thus, clearly indicates that the basis for, or correctness of, a certification that a rule does not have a significant economic impact on a substantial number of small entities is not a matter that is subject to judicial review. At most, only one type of judicial review is possible under the RFA: when the agency chooses the section option and prepares a regulatory flexibility analysis, the court may consider the analysis together with the rest of the agency record. Whether a defective analysis alone could be the basis for negating a rule is not entirely clear. However, as noted above, that is not the question before this Court today. The agency did not do a regulatory flexibility analysis. It chose the first option and made a section 605(b) certification, and that is certainly not a matter subject to judicial review.

There are very few reported cases under the RFA and some of them deal only with the situation where a regulatory flexibility analysis was done. The leading case concerning the certification option is Thompson v. Clark, 741 F.2d 401 (D.C. Cir. 1984). This case expressly clarified or overruled the positions taken in two earlier cases in the same circuit relied upon by the prospective intervenor or the plaintiffs, namely Sargent v. Block, 576 F.Supp. 882 (D. D.C. 1983), and Small Refiner Lead Phase-Down Task Force v. EPA, 705 F.2d 506 (D.C. Cir. 1983).

The Court of Appeals in Thompson v. Clark held that a court could not review either the determination of an agency to make the certification, or the question of whether the agency even gave a statement explaining its determination. The Court, supra, at 404-405, stated:

> The express language of the Regulatory Flexibility Act leaves little to the imagination on the issue of judicial review . . . Section 611(a) is dispositive with respect to appellant's substantive claim. The certification that §§ 603 and 604 do not apply to this rulemaking because the rule will not have a significant economic impact on a substantial number of small entities cannot possibly be understood as anything other than a "determination by an agency concerning the applicability of any of the provisions of this chapter." Similarly, § 611(b) is dispositive with respect to the procedural claim. The alleged failure to publish a statement of reasons as § 605 requires surely calls into question "compliance or noncompliance of the agency with the provisions of this chapter."

It is conceded that the RFA, as written, might be viewed as encouraging agencies to do certifications, rather than regulatory flexibility analyses. Because of this oddity, the Court in Thompson v. Clark, supra, at 405-408, did an exhaustive analysis of all the possibly relevant sections of the RFA and the legislative history behind them. The Court concluded, supra at 406, that:

> Although we find it unnecessary to consider the legislative history in light of the unambiguous language precluding judicial review, . . . we note that, far from supporting appellant's interpretation, it confirm our analysis.

Defendant is aware of no cases which would allow judicial review of the agency's certification. In Mid-Tex Electric Cooperative, Inc., v.

Federal Energy Regulatory Commission, 773 F.2d 327 (D.C. Cir. 1985), cited by plaintiffs, the court did not consider this precise issue. In another case raised by plaintiffs, Texarkana Livestock Commission v. U.S. Department of Agriculture, 613 F.Supp. 271, 277 (E.D. Tex. 1985), the basis of the court's ruling is unclear, though the District Judge expressly stated that he "is not ruling on the propriety of the Department's certification." The United States Court of International Trade, in the final reported case, Mast Industries, Inc. v. Regan, 596 F.Supp. 1567, 1573 n. 9 (Ct. Int'l Trade, 1984), stated that agency compliance or noncompliance with the RFA is specifically precluded from judicial review by 5 U.S.C. 611.

In summary, any challenge by the prospective intervenor or the plaintiffs to the agency's certification must fail since judicial review is prohibited.

(b) Factual Correctness of the Certification. Even if this issue were subject to judicial review, there is substantial evidence in the rulemaking record to support the agency's determination that the amended orders will not have a significant economic impact on a substantial number of small entities.

At the outset it should be noted that the prospective intervenor is under several misconceptions regarding the effects of the amended orders. This is understandable since the prospective intervenor did not appear at the hearing or offer any evidence or comments in the rulemaking proceeding.

The first misconception is that all producers and handlers in a federal milk marketing area are substantively regulated. In fact, producers are not directly regulated under milk marketing orders; only handlers are. To the extent that producers located in a marketing area may be viewed as indirectly regulated, such regulation only occurs if the producer chooses to deliver his milk to a handler regulated under the marketing order. The producer always is free to decide to deliver to an unregulated handler. Handlers are regulated based on their distribution of milk, rather than their plant location. Thus, for example, a handler located in the Order 4 marketing area who chooses to distribute less than 15 percent of his milk within the Order 4 marketing area is not substantively regulated under Order 4 except on the actual milk that he distributes in the Order 4 marketing area. All across the United States there are handlers located in federal order marketing areas who are either unregulated or regulated under a different marketing order. One client of plaintiffs' counsel, for example, is physically located in the Order 4 marketing area and freely chose to design his milk movements so as to be regulated under a Florida milk marketing order. The testimony at the rulemaking hearing cited several examples where handlers chose to alter their milk distribution and switch between Order 4 and Order 2. No one can predict which individual producer or handler may now make a business decision regarding federal regulation. One cannot assume, however, as prospective intervenor does, that such choices cannot be made by producers or handlers.

The second misconception is that the producers and handlers in the expansion area have not previously been regulated. This is just not true. Over 84 percent of the producers in the expansion area are already delivering to Order 2 and Order 4 handlers (50 Fed. Reg. 32724, 32725) and seven of the fifteen fluid milk handlers are already substantively regulated to some degree by federal milk marketing Orders 2 and 4 (50 Fed. Reg. 32719). To the extent any producers and handlers in the expansion area do not operate under these federal milk marketing orders, they are regulated by a state agency, the Pennsylvania Milk Marketing Board (the PMMB). The PMMB has producer and retail pricing provisions. Reports and recordkeeping are required by the PMMB. There is no credible evidence in the rulemaking record to suggest, as prospective intervenor does, that a switch to federal regulation will suddenly impose a significant additional paperwork burden on any producer or handler. Contrary to prospective intervenor's assertion, no business will for the first time be subject to milk marketing regulations.

The crux of prospective intervenor's argument is that between 550 and 700 new producers will have their milk priced under the federal orders and that all these producers will receive $.75 to $1 per hundredweight less for their milk. This allegation is absolutely incorrect and contrary to the rulemaking record as will be shown below. However, even assuming, arguendo, that the allegation is correct, is this a "significant economic impact on a substantial number of small entities?" We think not. Prospective intervenor speculates this means a six percent to eight percent gross reduction in returns to these affected producers (Brief, page 10). After income taxes, social security, Medicare, etc., one might consider the net reduction in returns to be more in the range of four percent. A person grossing $30,000 per year might be able at best to buy a new television with this amount of money. One is hard pressed to consider such a reduction to be a "significant economic impact." Furthermore, it is a matter of record evidence that there are over 20,000 producers who will be operating under the amended orders. Prospective intervenor believes that three percent will be significantly affected. Is three percent a "substantial number," as that phrase is used in the RFA? Certainly the members of the Senate and the House of Representatives debating the RFA did not think so. They suggested that regulations having a significant economic impact on 40 percent (200 of 500) or 60 percent (15 of 25) of the small businesses or "several thousands or more" of the small businesses were affecting a "substantial" number of small entities (126 Cong. Rec. 24589 (1980)).

Therefore, even operating under prospective intervenor's greatly inflated estimates of economic impact, there is clearly not a "significant economic impact on a substantial number of small entities."

The rulemaking record actually shows that of these 550-700 producers, at least 570 are cooperative members who are already receiving a price that approximates the Order 4 or Order 2 pay price to producers. This fact was stated in the Secretary's Decision (50 Fed. Reg. 32722) and was largely based on the testimony of the plaintiff's witnesses (e.g., Rulemaking Hearing Transcript, pp. 3056-3057).

Dairylea Cooperative has 132 of these producers who are receiving approximately the federal order blend price (Rulemaking Hearing Transcript, pp. 3163, 3336), Lehigh Valley Farmers Cooperative has 263 (Rulemaking Hearing Transcript, pp. 3502, 3166-3167; Preliminary Injunction Transcript, November 21, 1985, pp. 14-15), Eastern Milk Producers Cooperative has approximately 125 (Rulemaking Hearing Transcript, pp. 2971, 2410-2411, Exhibit 43), and Farmers' Cooperative Dairy has 50 (Rulemaking Hearing Transcript, p. 3501; Preliminary Injunction Transcript, November 20, 1985, pp. 142, 156). In addition, Clover Farms Dairy has, since the hearing, become a fully regulated federal order handler and, thus, most of the 78 producers shown at the top of the Rulemaking Hearing Exhibit 43 should also be receiving the federal order blend price. Thus, it appears today that perhaps 648 of these 550 to 700 producers will receive at most a very small price reduction, and not the $.75 to $1 per hundredweight claimed by the prospective intervenor. Even if we generously posited that 100 farmers would incur price reductions of $1 per hundredweight, such a figure constitutes only three percent of the 3,500 producers located in the expansion area and one-half of one percent of the total producers in the amended orders. This is hardly a "significant economic impact on a substantial number of small entities."

IV. Conclusion

Prospective intervenor's only basis for intervention is the RFA, which allows intervention only for specified purposes. The reasons alleged in the motion and brief of prospective intervenor are not within the scope of those specified purposes. Hence, there is no legal authority for intervention and prospective intervenor's motion should be denied.

If intervention be granted, summary judgment should be accorded defendant since judicial review of the issues raised by the prospective intervenor is specifically precluded by statute. Even if judicial review were proper, summary judgment should be granted to defendant since the rulemaking record contains substantial evidence to support the determination that the amended orders will not have a significant economic impact on a substantial number of small entities.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Gregory Cooper, do hereby certify that on March 21, 1986, I caused a copy of the foregoing Defendant's Response To Motion For Leave To Intervene As An Amicus Curiae By The Chief Counsel For Advocacy; Defendant's Memorandum Of Points and Authorities in Support of Defendant's Response To Motion For Leave To Intervene As An Amicus Curiae By The Chief Counsel For Advocacy; and Order, to be served upon the following persons by mailing a copy thereof via first class, postage prepaid:

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Mr. SKELTON. I would like at this time to place in the record, without objection, the memorandum dated April 17, to the Secretary of the USDA from General Counsel Daniel Oliver.

[See appendix, p. 368.]

Mr. SKELTON. Do you have questions, Mr. Orban?

Mr. ORBAN. I do not have any questions.

Mr. SKELTON. We thank you very much.

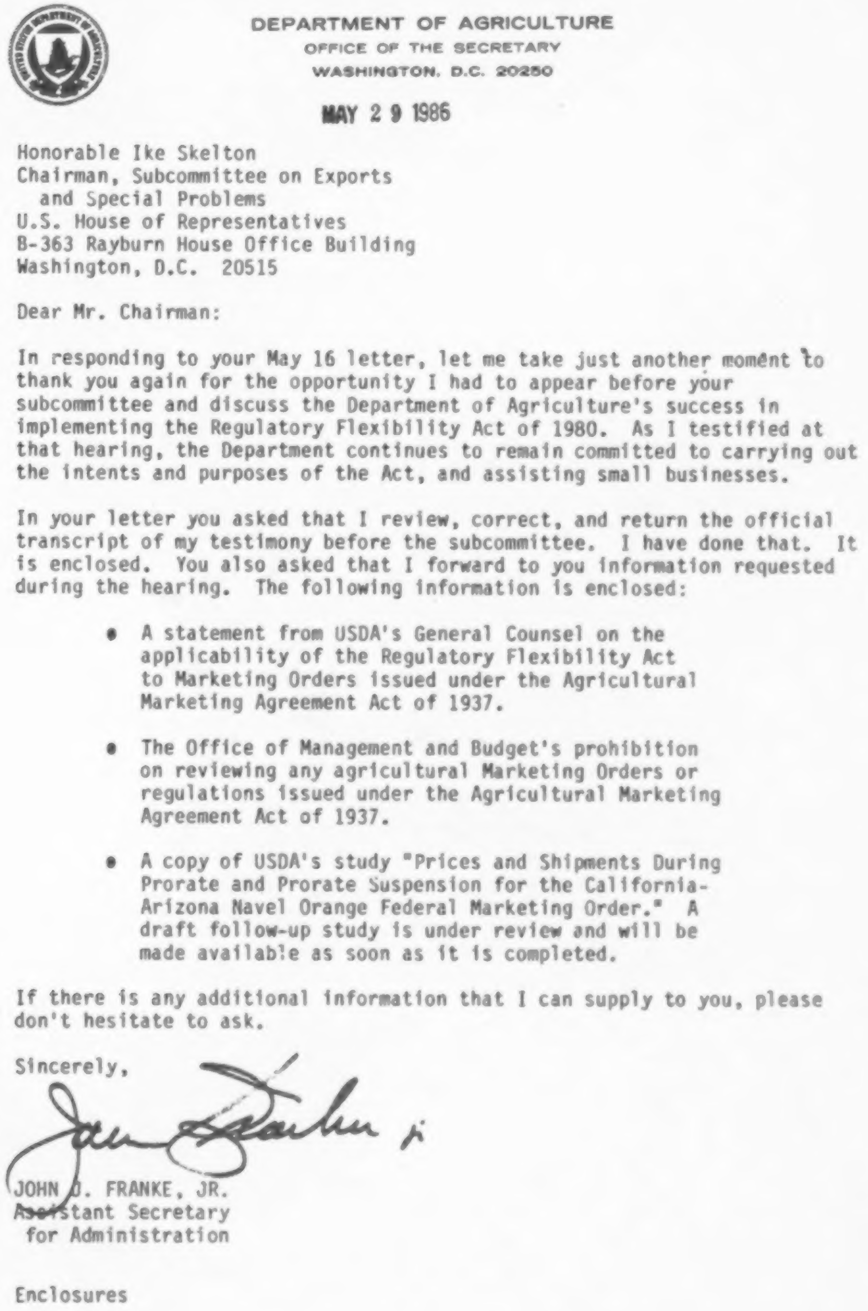
Mr. HANDLEY. My pleasure.

Mr. SKELTON. Thank you, sir.

[Whereupon, at 11 a.m., the subcommittee adjourned to reconvene subject to call of the Chair.]

APPENDIX

MATERIAL SUBMITTED BY U.S. DEPARTMENT OF AGRICULTURE IN RESPONSE TO QUESTIONS FROM HON. IKE SKELTON AND SUBCOMMITTEE STAFF DURING HEARING



DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

MAY 29 1986

Honorable Ike Skelton
Chairman, Subcommittee on Exports
and Special Problems
U.S. House of Representatives
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

In responding to your May 16 letter, let me take just another moment to thank you again for the opportunity I had to appear before your subcommittee and discuss the Department of Agriculture's success in implementing the Regulatory Flexibility Act of 1980. As I testified at that hearing, the Department continues to remain committed to carrying out the intents and purposes of the Act, and assisting small businesses.

In your letter you asked that I review, correct, and return the official transcript of my testimony before the subcommittee. I have done that. It is enclosed. You also asked that I forward to you information requested during the hearing. The following information is enclosed:

- A statement from USDA's General Counsel on the applicability of the Regulatory Flexibility Act to Marketing Orders issued under the Agricultural Marketing Agreement Act of 1937.
- The Office of Management and Budget's prohibition on reviewing any agricultural Marketing Orders or regulations issued under the Agricultural Marketing Agreement Act of 1937.
- A copy of USDA's study "Prices and Shipments During Prorate and Prorate Suspension for the California-Arizona Navel Orange Federal Marketing Order." A draft follow-up study is under review and will be made available as soon as it is completed.

If there is any additional information that I can supply to you, please don't hesitate to ask.

Sincerely,

JOHN J. FRANKE, JR.
Assistant Secretary
for Administration

Enclosures

United States
Department of
Agriculture

Office of
General
Counsel

Washington
D.C
20250

[illegible] 17 [illegible]

MEMORANDUM

TO : The Secretary

FROM : Daniel Oliver
General Counsel

SUBJECT: Applicability of the Regulatory Flexibility Act to Marketing Orders Issued under the Agricultural Marketing Agreement Act of 1937

At a hearing on April 16, 1986, before the House Subcommittee on Export Opportunities and Special Small Business Problems of the Small Business Committee, Assistant Secretary Franke was requested to provide a legal opinion from the General Counsel on the applicability of the Regulatory Flexibility Act to marketing orders issued under the Agricultural Marketing Agreement Act of 1937. This memorandum responds to that request.

The Regulatory Flexibility Act (5 U.S.C. §§ 601-12) (RFA) is an attempt to ensure that small businesses, small governmental units, and non-profit organizations are treated fairly in the regulatory process. It does so by imposing on government agencies certain procedural requirements that force the agencies to examine the impact of a new regulation on such small entities, and to consider alternatives to a proposed regulation in order to minimize the burden of the regulation on those entities.

The RFA applies to any rule for which an agency publishes a general notice of proposed rulemaking pursuant to 5 U.S.C. § 553(b) or pursuant to any other law, which rule will have a significant economic impact on a substantial number of small businesses. The primary procedural step imposed by the RFA is the preparation by the agency of an initial regulatory flexibility analysis (IRFA) for every rule to which the Act applies. The IRFA must describe the impact of the proposed rule on small entities. Each IRFA must contain:

(1) a description of the reasons why action by the agency is being considered;

(2) a succinct statement of the objectives of, and legal basis for, the proposed rule;

(3) a description of, and where feasible, an estimate of the number of small entities to which the proposed rule will apply;

(4) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills

necessary for the preparation of the report or record;

(5) an identification of all relevant federal rules which may duplicate, overlap, or conflict with the proposed rule; and

(6) a description of any significant alternatives to the proposed rule which accomplish the objectives of the applicable statutes and which minimize the economic impact of the proposed rule on small entities.

An agency promulgating a rule must make the IRFA available for public comment by publishing it in the *Federal Register* with the rule's general notice of proposed rulemaking.

The second procedural step imposed by the RFA is the preparation of a final regulatory flexibility analysis (FRFA) for every rule to which the RFA applies. The FRFA must contain:

(1) a succinct statement of the need for, and the objectives of, the rule;

(2) a summary of the issues raised by the public comments in response to the IRFA, an assessment by the agency of such issues, and a statement of any changes made in the rule as a result of the public comments; and

(3) a description of each of the significant alternatives to the rule consistent with the objectives of the applicable statute and designed to minimize any significant impact on small entities which was considered by the agency, and a statement of the reasons why each one of such alternatives was rejected.

The FRFA need not be published in the *Federal Register*, but an agency must make copies available to the public, and must include a statement describing how the public may obtain copies in the publication of the final rule.

The RFA requires the preparation of IRFAs and FRFAs unless the head of an agency certifies that the rule will not, if promulgated, have a "significant economic impact" on a "substantial number" of "small entities." Each of these three terms requires a definition. A "significant economic impact" measures a regulation's costs and benefits to small entities. An agency should isolate and measure direct economic costs, analyze the market share of small businesses before and after the rule, examine effects on small entities' competitive position vis-a-vis large businesses, and account for compliance costs arising from recordkeeping and personnel workload changes. Economic impact can be considered "significant" if small entities could reasonably say that a proposed rule would reduce or eliminate their profit margin.

A "substantial number" is defined with more precision, due to some discussion in RFA's legislative history. Those discussions suggest that forty percent of the small entities in a given geographical or product market would certainly qualify as a "substantial number." *See*, 126 Cong. Rec. H8469 (daily ed. Sept. 8, 1980).

"Small entities" are defined, in the case of small agricultural producers, with reference to standards published by the Small Business Administration. *See*, 13 C.F.R. § 121.2 (1985). A business engaged in agricultural production is a "small business" under the RFA if it has annual gross revenue for the last three fiscal years of less than $100,000.

A final aspect of the RFA, the scope of the Act, merits a mention. Statements made during Congressional debate on the RFA indicate that the Act was to be given broad application. "The legislation is intended to be as inclusive as possible, and doubts as to its applicability should be resolved in favor of complying with the provisions of the Act." 126 Cong. Rec. H8469 (Sept. 8, 1980).

The Agricultural Marketing Agreement Act of 1937 (7 U.S.C. § 601 *et seq.*) (AMAA) allows the Secretary of Agriculture to enter into marketing agreements with, and to issue orders applicable to, processors, associations of producers, and other handlers of agricultural commodities. The means by which the agreements and orders are issued have caused some uncertainty as to the applicability of the RFA to agreements and orders issued under the AMAA.

The AMAA states that "the Secretary of Agriculture shall have the power, *after due notice and opportunity for hearing*, to enter into marketing agreements..." (97 U.S.C. § 608b) and when the Secretary decides to issue an order, "he shall give *due notice of and an opportunity for a hearing* upon a proposed order," (7 U.S.C. § 608c(3)). These sections are interpreted to require marketing agreements and orders to be promulgated according to the "formal rulemaking" provisions of the Administrative Procedure Act (5 U.S.C. §§ 556-57). Regulations setting out the procedures governing proceedings to formulate marketing agreements and orders have been promulgated (7 C.F.R. §§ 900.1-900.18 (1985)).

Such a proceeding is instituted by filing a notice of hearing with the hearing clerk, and publication of the notice of hearing in the *Federal Register* (7 C.F.R. § 900.4). The hearing is conducted before an administrative law judge, and evidence is presented. The record of the proceeding is transmitted to the Secretary, and thereafter, the Secretary renders a decision (7 C.F.R. §§ 900.13-900.13a). If the Secretary decides that an agreement or order should issue, copies of the agreement are mailed to the handlers, and notice of the order is published in the *Federal Register* (7 C.F.R. § 900.14). Amendments to such a marketing order, authorized by 7 U.S.C. § 608c(7)(c)(iv), are also made through "formal rulemaking" procedures. *See*, 7 C.F.R. §§ 900.50-900.71.

Under the "formal rulemaking" procedural framework applicable to AMAA marketing orders and agreements, an analysis of whether the RFA applies encompasses two major inquiries: does the RFA apply to marketing agreement and order proceedings, and, if it does, at what stage of the proceedings need the RFA procedural steps be taken.

It is my opinion that marketing agreements and orders are "rules" under the RFA, and that the procedural steps mandated by RFA must be followed with respect to every proposed agreement, order, or amendment thereto, unless the agency can certify and substantiate that the rule would not have a significant economic impact on a substantial number of small entities. As noted above, the RFA applies whenever an agency is required to publish a general notice of proposed rulemaking pursuant to 5 U.S.C. § 553 *or pursuant to any other law*. As also noted above, 7 U.S.C. §§ 608b and 608c(3) require the Secretary to give "due notice and an opportunity for a hearing," when a marketing agreement, order, or amendment thereto, is proposed. Also, a validly issued regulation, such as 7 C.F.R. § 900.4 (requiring publication of a notice of a hearing for a proposed agreement or order) has the force and effect of law. *See, e.g.*, *Standard Oil Co. v. United States*, 316 U.S. 481 (1942); *United States v. Nixon*, 418 U.S. 683, 695 (1973). Such statutory provisions and regulations should be regarded by the agency as "other laws" under the RFA, which trigger the procedural steps of the preparation of the IRFAs and FRFAs in the course of marketing agreement and order rulemaking. Congress included formal rulemaking procedures within the rulemaking subject to the RFA by making the RFA applicable to "other laws" as well as to 5 U.S.C. § 553. Since formal rulemaking was not specifically excluded, it is consistent with the broad scope of the RFA to subject rulemaking of this kind to the RFA's procedural requirements, so long as a proposed agreement or order will have the required significant economic impact on a substantial number of small entities.

It is important to note at this point that 5 U.S.C. § 605(b) allows the head of an agency, or his delegate, to certify that a proposed rule will not have a significant impact on a substantial number of small entities. The RFA specifically provides:

> If the head of the agency makes a certification under the preceeding sentence, the agency shall publish such certification in the Federal Register, at the time of publication of the general notice of proposed rulemaking or at the time of the publication of the final rule, *along with a succinct statement explaining the reasons for such certification*, and provide such certification and statement to the Chief Counsel for Advocacy of Small Business Administration. (Emphasis supplied.)

Such a certification under § 605(b) should be accompanied by the required explanation, that requires a collection and analysis of data from the affected industry in order that the regulated community and the Small Business Administration may be apprised of the factual basis of the certification.

Since the RFA is applicable to proposed marketing agreements and orders, the agency must determine at which stage in the formal rulemaking procedure should IRFAs and FRFAs be made available for review by interested members of the public. RFA requires that IRFAs be "published in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule." 5 U.S.C. § 603(a). It would be inappropriate for the agency to publish an IRFA along with the notice of public hearing on a proposed agreement, order, or amendment thereto, because at that point it is unknown what the provisions and effect of the proposed rule might be. It appears to be the procedure of AMS to solicit comments on the impact of the proposals or small entities at this stage of the proceedings. For example, a notice of public hearing on proposed amendments to the Filberts/Hazelnuts Marketing Order (7 C.F.R. § 982.1 *et seq.*) contained the following language:

> The Regulatory Flexibility Act (Pub. L. 96-354), effective January 1, 1981, seeks to ensure that, within the statutory

> authority of a program, the regulatory and information requirements are tailored to the size and nature of small businesses. Interested persons are invited to present evidence at the hearing on the probable regulatory and informational impact of the proposals on small businesses. 50 Fed. Reg. 5995 (February 13, 1985).

This statement is appropriate for this stage of the rulemaking proceedings. The "notice of public hearing" stage of formal rulemaking is not the equivalent of this "notice of proposed rulemaking" stage of § 553 informal rulemaking. However, the above statement should be expanded in order to inform the public of the desirability of comments which address another goal of the RFA, namely "alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes...which minimize the significant impact of rules on small businesses..." (5 U.S.C. § 601 note). Therefore, I recommend that the following language be added to the above statement:

> ...and on alternative regulatory approaches which minimize the impact of the proposals on small businesses.

The IRFA should be included in the notice of the Secretary's recommended decision published pursuant to 7 C.F.R. § 900.12. This corresponds to the "notice of proposed rulemaking" stage of informal rulemaking because the full text of the proposed rule is set out by the agency at this point. AMS follows this procedure on occasion. *See*, 50 Fed. Reg. 31850 (August 7, 1985) (Lemon Marketing Order proposed rule containing a brief discussion on small business impact); 50 Fed. Reg. 33748 (August 21, 1985) (Proposed agreement authorizing a research and promotion program for Texas vegetables). Finally, a statement that the FRFA is available for public comment, required by 5 U.S.C. § 604(b), should be included in the notice of issuance of the agreement or order published pursuant to 7 C.F.R. § 900.14(e).

A draft OGC memo written in October 1983 concluded that the RFA was not applicable to marketing orders. The following analysis addresses the points made in that memo. The first contention was that marketing orders issued under formal rulemaking (5 U.S.C. §§ 556, 557) were exempt from RFA because RFA's definition of a "rule" mentioned only § 553 informal rulemaking. This contention misstates the law, because, as noted previously, the RFA applies to any rule "for which the agency publishes a general notice of proposed rulemaking pursuant to section 553(b) of this title, *or any other law*" (5 U.S.C. § 601(2)) (emphasis supplied). RFA is therefore not restricted solely to informal rulemaking. The administrator's decision, after public hearing, to issue an order is published as a general notice of a *proposed rule* (*See, e.g.*, 50 Fed. Reg. 31850 (August 7, 1985)), so the RFA is applicable under the plain meaning of the statutory language. Mere omission of a reference to sections 556 and 557 rulemaking is not indicative of Congressional intent to exclude rulemaking under those sections from the RFA in light of the "or other laws" statutory language and the legislative history demonstrating Congressional intent that the statute be broadly applicable.

The second contention is that the AMAA requires uniformity in the application of regulations issued under the order for all persons regulated thereunder, and that USDA is unable to utilize the RFA flexible regulation approach to provide less stringent regulatory treatment of small businesses. This argument misinterprets RFA, assuming as it does that RFA amends substantive law. RFA requires agencies to employ a procedure in which they solicit and discuss alternatives to proposed rules, and quantify the impact of regulations on small businesses. RFA does not mandate differential treatment for large and small businesses. AMAA's requirement of uniform applicability in no way precludes RFA analyses. Ideally, RFA analysis would elicit a AMAA marketing agreement or order, uniformly applicable, which, among all regulatory alternatives, minimizes the burden on the small entities to which it applies.

The memo's third contention is that the purpose of RFA is to allow "favorable discrimination" as to small businesses through the means of "two-tier" regulations, which treat small businesses less stringently, and that such differential treatment is not allowed under the AMAA. Such "tiering" is allowed under RFA, but only as a means by which a regulation may be promulgated to minimize its impact on small businesses. RFA does not require tiering of regulations, so a statute such as AMAA is still amenable to RFA analysis. Even when tiering is precluded, a regulation must be analyzed for ways to minimize its impact on small businesses.

Another argument that has been raised concerning RFA's applicability to AMAA agreements and orders is based on the way by which such agreements and orders are established and administered. Marketing agreements become effective only after a certain percentage of affected growers or handlers voluntarily agree to be bound by it. Marketing orders are administered by committees composed of industry members. It is argued that the voluntary, self-administered nature of these agreements and orders, as well as the uniform applicability of the orders mandated by AMAA, make RFA analysis unnecessary because the agreements are imposed by small entities upon themselves. Small businesses, it is argued, will consider their own self-interest in minimizing the regulatory burden when they put the marketing agreement or order together. However, the RFA makes no exception for rules promulgated with the assistance of the regulated community, or for rules voluntarily agreed to. Under the provisions of the RFA, any rule for which the agency publishes a notice of proposed rulemaking must be subjected to a regulatory flexibility analysis unless it can be certified that the rule will not have a significant economic impact on a substantial number of small businesses. The fact that a marketing agreement or order is voluntarily entered into, or is industry-administered, is simply irrelevant for purpose of the RFA. In addition, there have been allegations that "industry administration" of a marketing order does not provide any assurance that the interests of an independent producer will be adequately considered by the administrative committee.

The attachments to this memorandum are examples of regulatory flexibility considerations published by the USDA and other agencies in similar situations.

Attachments

pre-notice solicitation of comments

Proposed Rules

Federal Register
Vol. 50, No. 30
Wednesday, February 13, 1985

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 982

[Docket No. F&V AO-226-A6]

Filberts/Hazelnuts Grown in Oregon and Washington; Hearing on Proposed Amendment of the Marketing Agreement, as Amended, and Order, as Amended

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Public hearing on proposed amendment and text of proposals.

SUMMARY: The hearing is being held to consider proposed changes in the filbert/hazelnut marketing agreement and order to improve program operations. The principal issues to be considered would: (1) Change the method of establishing marketing policy and volume regulations to allow more flexibility to react to market conditions and provide for market growth; (2) change Board representation to eliminate any reference to either cooperative or independent growers or handlers and recognize industry composition; (3) provide authority for advertising and promotion programs; and (4) provide authority for crediting a handler's assessment for certain kinds of advertising and promotion. Also to be considered are a number of technical changes.

DATE: The hearing will begin at 9:00 a.m., local time, Wednesday, February 20, 1985.

ADDRESS: The hearing will be held in Room 229, Green/Wyatt Federal Building, 1220 SW., Third Avenue, Portland, Oregon.

FOR FURTHER INFORMATION CONTACT: Frank M. Grasberger, Acting Chief, Specialty Crops Branch, Fruit and Vegetable Division, Agricultural Marketing Service, U.S. Department of Agriculture, Washington, D.C. 20250, (202) 447-5053.

SUPPLEMENTARY INFORMATION: This amendment was proposed by the Filbert/Hazelnut Marketing Board established under the marketing agreement and order program which covers filberts/hazelnuts grown in Oregon and Washington. The Department of Agriculture proposes that it be authorized to make any necessary conforming changes which may result from this proceeding.

A pre-notice press release was issued December 7, 1984, inviting comments on the Board's proposals until December 31. One comment was received from the California Almond Growers Exchange supporting all the proposed changes.

This administrative action is governed by the provisions of sections 556 and 557 of Title 5 of the United States Code, and therefore is excluded from the requirements of Executive Order 12291.

The Regulatory Flexibility Act (Pub. L. 96-354), effective January 1, 1981, seeks to ensure that, within the statutory authority of a program, the regulatory and information requirements are tailored to the size and nature of small businesses. Interested persons are invited to present evidence at the hearing on the probable regulatory and informational impact of the proposals on small businesses.

The hearing is called pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 *et seq.*), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR Part 900). The proposed amendment, set forth below, has not received the approval of the Secretary of Agriculture.

The purpose of the hearing is to receive evidence with respect to the economic and marketing conditions which relate to the proposed amendment, hereinafter set forth, and any appropriate modifications thereof, of the marketing agreement and Order No. 982, both as amended, regulating the handling of filberts/hazelnuts grown in Oregon and Washington.

PROPOSED BY THE FILBERT/HAZELNUT MARKETING BOARD

Proposal No. 1

Section 982.9 is deleted.

Section 982.9 Cooperative handler. [Deleted]

Section 982.10 is deleted.

Section 982.10 Independent handler. [Deleted]

Proposal No. 2

Section 982.16 is revised to read as follows:

Section 982.16 Inshell trade acquisitions.

"Inshell trade acquisitions" means the quantity of inshell filberts acquired by the trade from all handlers during a marketing year for distribution in the continental United States.

Proposal No. 3

Section 982.17 is revised to read as follows:

Section 982.17 Marketing year.

"Marketing year" means the 12 months from July 1 to the following June 30, both inclusive, or such other period of time as may be recommended by the Board and established by the Secretary.

Proposal No. 4

Section 982.30 is revised to read as follows:

Section 982.30 Establishment and membership.

(a) There is hereby established a Filbert/Hazelnut Marketing Board consisting of 10 members, each of whom shall have an alternate member, to administer the terms and provisions of this part. Each member and alternate shall meet the same eligibility qualifications. The 10 member positions shall be allocated as follows:

(b) Four of the members shall represent handlers, as follows:

(1) One member shall be nominated by the handler who handled the largest volume of filberts during the marketing year preceding the marketing year in which nominations are made;

(2) One member shall be nominated by the handler who handled the second largest volume of filberts during the marketing year preceding the marketing year in which nominations are made;

(3) One member shall be nominated by the handler who handled the third largest volume of filberts during the marketing year preceding the marketing year in which nominations are made; and

(4) The fourth handler member shall be nominated by and represent all other handlers.

AMAA IRFA

Proposed Rules

Federal Register
Vol. 50, No. 152
Wednesday, August 7, 1985

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 910

[Docket No. AO-144-A14-RO1]

Lemons Grown in California and Arizona; Recommended Decision and Opportunity to File Written Exceptions to Proposed Further Amendment of the Marketing Order and Proposed Marketing Agreement

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule.

SUMMARY: This notice invites written exceptions on a proposed amendment of the lemon marketing order, and a proposed marketing agreement for lemons. The principal changes would: (a) Require volume regulations by prorate district; (b) require two-week prorate periods; (c) require a minimum 8 week period of open movement of lemon shipments during the June-September period each year; (d) exempt special purpose shipments of lemons, including shrink-wrapped lemons, from prorate regulations; (e) exempt shipments of premium quality lemons during specified periods and provide authority for the establishment of quality standards and inspection and certification procedures for such lemons; (f) provide for marketing incentive allotments; (g) authorize undershipments to be carried forward for two weeks or longer; (h) authorize generic advertising projects and allow handlers to request a refund of assessments for such project; (i) limit committee tenure to 3 consecutive two-year terms of office; (j) authorize mail balloting for independent members and [illegible]r terms for all members; (k) [illegible] from August 1 to September 1, the beginning date of members' term of office and the fiscal year; (l) provide for a continuance referendum every six years; (m) and revise handler reporting requirements and establish recordkeeping requirements. The intent of the proposed changes is to improve the effectiveness of the program. The proposed marketing agreement, which is a companion agreement between the Secretary and handlers of the regulated commodity, would contain essentially the same terms and provisions as the current amended lemon marketing order, and as hereby proposed to be further amended.

DATE: Written exceptions to this recommended decision must be filed by September 6, 1985.

ADDRESS: Interested persons may file written exceptions to this decision with the Hearing Clerk, United States Department of Agriculture, Room 1077, South Building, Washington, D.C. 20250. Four copies of all written exceptions should be submitted, and they will be made available for public inspection during regular business hours (7 CFR 1.27(b)).

FOR FURTHER INFORMATION CONTACT: William J. Doyle, Chief, Fruit Branch, Fruit and Vegetable Division, Agricultural Marketing Service, United States Department of Agriculture, Washington, D.C. 20250, telephone 202-447-5975.

SUPPLEMENTARY INFORMATION: Prior documents in this proceeding: Notice of Hearing published in the January 13, 1983, issued of the Federal Register (48 FR 1508), Amended Notice of Hearing published in the Janaury 28, 1983, issued of the Federal Register (48 FR 3624). Notice of Opportunity to comment on Proposed Rulemaking published in the October 6, 1983, issued of the Federal Register (48 FR 45686). Notice of Reopened Hearing published in the December 13, 1983, issue of the Federal Register (48 FR 55472). Notice of an Additional Hearing Session published in the February 1, 1984, issued of the Federal Register (49 FR 4004). Extension of Time for Filing ofBriefs published in the July 13, 1984, issue of the Federal Register (49 FR 28568), and Further Extension of Time for filing Briefs published in the September 20, 1984, issue of the Federal Register (49 FR 36882).

This administrative action is governed by the provisions of Sections 556 and 557 of Title 5 of the United States Code, and therefore is not subject to the requirements of Executive Order 12291.

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this recommended decision with respect to the proposed further amendment of Marketing Order No. 910, hereinafter referred to as the "order", regulating the handling of lemons grown in California and Arizona, the proposed issuance of a marketing agreement regulating the handling of lemons grown in California and Arizona; and of the opportunity to file written exceptions thereto. Copies of this decision may be obtained from William J. Doyle.

This notice is issued pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 *et seq.*), hereinafter referred to as the "act" and the applicable rules of practice and procedure governing the formulation of marketing agreements and orders (7 CFR Part 900).

This proposed amendment and proposed marketing agreement were formulated on the record of public hearings held in Oak View, California, on February 14–18, 1983, Ventura, California, on January 10–13, 1984, Yuma, Arizona, on January 18–20, 1984, Bakersfield, California, on January 23–27, 1984, and again in Ventura, California, on February 13–28, 1984. The Notice of Hearing contained proposals submitted by the Lemon Administrative Committee, hereinafter referred to as the "committee", Perry L. Walker, N.J. Riebe, and the Fruit and Vegetable Division, AMS, USDA. The Reopened Notice of Hearing contained proposals submitted by Harry M. Snyder for Consumers Union of the United States, Inc., R.W. Knight, Dennis N. Torigian, Frank M. Lick, Joseph E. Coberly, Jr., Stephen F. Moore, the Lemon Administrative Committee, the Capital Legal Foundation on behalf of Sequoia Orange Company, Inc. and Exeter Orange Company, Inc., Perry L. Walker, Robert E. Herrick, Pure Gold, Inc., Tom C. Cole, David C. Roddick, Ebed Ariev, and Joseph D. Park.

The decision includes a number of recommendations which would provide flexibilities intended to lessen regulatory controls over the California-Arizona lemon industry. Such flexibilities are deemed to be initial steps in a continuing process whereby the industry will rely more on natural market forces to correct lemon marketing problems and less on regulatory actions. Such flexibilities should contribute in a substantial way to addressing both short- and long-run marketing problems.

Material Issues

The material issues of record are as follows:

(1) Terminate the lemon marketing order or eliminate the prorate provisions of the order.

(2) Redefine the production area to exclude Districts 1 and 3.

(3) Require establishment of lemon volume regulation by prorate district.

(4) Require prorate periods of two weeks in duration or longer periods as may be recommended by the committee.

(5) Require a minimum of eight weeks of open movement of lemon shipments during the June–September period each year.

(6) Exempt special purpose shipments of lemons, including shrink-wrapped lemons, from prorate regulations in limited amounts.

(7) Exempt shipments of premium quality lemons during specified periods and provide for the establishment of quality standards and inspection and certification procedures for such lemons.

(8) Provide for marketing incentive allotments.

(9) Authorize undershipments to be carried forward two weeks or longer.

(10) Revise procedures relating to open certification of lemons on-tree.

(11) Include export shipments to Japan under prorate regulation.

(12) Authorize the committee to conduct marketing research and promotion projects, including paid advertising, and allow for handlers to request refunds of assessments for such projects.

(13) Limit committee members' tenure to 3 consecutive two-year terms of office.

(14) Provide for staggered terms of office of committee members.

(15) Authorize mail balloting for nominations of independent members of the committee.

(16) Provide for additional alternate handler members on the committee.

(17) Redesignate the "non-industry member" on the committee as the "public member" and expand such member's role.

(18) Change the beginning and ending dates of members' terms of office from a two-year period beginning on August 1 to a two-year period beginning on September 1.

(19) Revise the size and composition of the committee and make related changes in nomination, quorum, and voting requirement provisions.

(20) Provide for consumer affairs advisors to the committee.

(21) Authorize committee member compensation for attending meetings to increase to a maximum of $100 per meeting.

(22) Authorize the committee to assess a late payment charge on overdue assessments.

(23) Revise provisions relative to allotment loans.

(24) Revise district boundaries to exclude Monterey County, California, from District 1 and include such county in District 2.

(25) Provide for a continuance referendum to be held every six years.

(26) Revise handler reporting requirements and establish recordkeeping requirements.

(27) Revise definitions for fiscal year and carload.

(28) Provide for a handler marketing agreement.

~~(29) Make~~ conforming changes.

Small Businesses

As stated in the notice of hearing, interested person were invited to present evidence during the hearing on the probable economic impact on small growers and handlers of proposed amendments to the California-Arizona lemon order. Interested persons are again invited to comment on such economic impacts with respect to the material issues discussed in this recommended decision. Such comments will be considered prior to a final decision to be issued by the Secretary.

The purpose of the Regulatory Flexibility Act (Pub. L. 96-354)(RFA) is to fit regulatory action to the scale of business subject to such action in order that small businesses will not be unduly or disproportionately burdened. The Agricultural Marketing Agreement Act of 1937, as amended (AMAA), requires the application of uniform rules to regulated handlers. Under the allotment program for lemons the act requires the establishment of uniform rules which apportion such allotments equitably among all regulated handlers. Marketing orders and rules proposed thereunder are unique in that they are normally brought about through group action of essentially small entities for their own benefit. Thus, there should be no conflict between the goals of the RFA and the AMAA with respect to small business entities. This is especially true in this proceeding since handlers covered under M.O. 910 are predominantly small businesses and the order reflects the views and consensus of such small businesses.

Lemons produced in California and Arizona account for virtually all of the lemons produced in the United States. A small quantity of lemons is grown in Florida. Lemons are sold in essentially three markets: fresh domestic (including Canada); fresh export; and processing. In 1982–83, the percentage utilization by market was 28 percent fresh domestic, 18 percent fresh export and 54 percent processed. The percentage of the crop utilized in processing had been trending upward through the 1982–83 season, while fresh domestic use of lemons has been relatively constant in the last several years.

The California-Arizona lemon industry is characterized by a relatively large number of small entities. There were approximately 2,079 farms growing lemons in 1978 compared to about 8,813 farms in 1984. The average farm size was about 26 acres in 1978 compared to an average size of 8 acres in 1984. Total lemon acreage reached a high of 91,316 acres in 1975–76 and has been declining since that time. Total acreage in 1984–85 is estimated at 67,800 acres. Based on the economics of the lemon industry and on evidence on the record a small grower can be defined as one whose total annual return is less than one million dollars. Therefore, virtually all California-Arizona lemon growers are small growers.

There were approximately 81 handlers of California-Arizona lemons in the 1982–83 season. During that year, the average lemon handler handled slightly more than 286 carloads in fresh domestic channels. During 1982–83 there were 19 marketing organizations in the industry, seven of which marketed in excess of 66 percent of the domestic lemons.

A brief filed on behalf of the U.S. Small Business Administration (SBA) argues that the RFA applies to these formal rulemaking proceedings and that the USDA is required to conduct an initial and final Regulatory Flexibility Analysis with respect to this proceeding.

Further, the SBA states that the regulatory flexibility analysis should include: (1) A statement of need for the regulation; (2) a description and estimate of the number of affected small entities; (3) a discussion of alternative proposals and; (4) answers to specific questions on prorate. The hearing record and this recommended decision contain a description of the regulated industry; statement of need for proposed regulations or amendments to existing regulations; discussions of alternative proposals; and answers to specific questions on prorate and other issues. Therefore the analysis described by the SBA has been made an integral part of this formal rulemaking proceeding.

The SBA also proposed alternatives to prorate regulation which could benefit small businesses. Such alternatives are addressed within this recommended decision. As such, within the confines of the AMAA, such alternatives as exemptions for small handlers, organic and shrink-wrapped lemons, and providing for generic advertising are proposed to be adopted. Other flexibilities not mentioned by the SBA are also proposed to be adopted. The cumulative effect of these recommended amendments should be beneficial and applicable across the entire industry. To the extent that such flexibilities are adopted, small businesses will be able to derive benefits from them.

While regulations issued under these orders impose some costs on affected handlers, and the number of such handlers may be substaintial, the added burden on small entities, if present at all, is not significant.

Findings and Conclusions

The following findings and conclusions on the material issues are based on the record of the hearing: (1) The hearing record contains considerable testimony from both industry and nonindustry witnesses who supported proposals to eliminate or phase out the flow to market provisons of the order, i.e. prorate, or to terminate the order.

Such witnesses testified that prorate: contributes to chronic overproduction; slows the industry's response to changing technologies; causes subsidization of the products market; protects inefficient or marginal producers; causes increased capitalization of groves; may be a barrier to entry at the handler level; results in resource misallocation and subsequent social welfare losses; promotes undermarketing of lemons by limiting competition and; attracts passive investors into the industry. Several other arguments were raised with respect to possible deleterious effects of prorate but these were generally variations of the aforementioned points. Both industry and non-industry witnesses argued in favor of continuation of the order and/or the prorate provisions. These witnesses argued that prorate: reduces risks to producers; results in stability in the fresh domestic market by providing stable, balanced supplies and reasonably stable prices; contributes to year round availability of lemons which benefits the fresh domestic, export and products markets and the consumer; provides stability in the farm labor force; provides stability in the transportation sector and reduces transportation costs by providing regularity of shipments; builds confidence in the agricultural financing sector, allowing growers, especially small growers, to obtain necessary financial resources and; provides the industry with the only equitable method of dealing with significant overproduction.

The current overproduction in the lemon industry was credited to the effects of prorate by some witnesses. However, growers, handlers, economists and other witnesses identified several contributing factors which appear to have had a more profound effect than prorate. These factors include tax laws which encouraged investment in lemon acreage as a means to shelter other income, losses of European and other export markets for lemons due to increased foreign production of lemons, increased freight rates, the strength of the U.S. dollar, attractive prices for lemon products in the 1970's, and consistent back to back years of heavy production unrestricted by a natural event such as a damaging freeze. Several witnesses claimed that prorate prevents or slows down the industry's reaction to such overproduction.

The Department recognizes that testimony for and against prorate contains many valid points. However, upon careful analysis of the facts, it is reasonable to conclude that changes in tax laws and the fact that lemons are a long-term rather than a single season investment for growers have contributed to overproduction of lemons to a greater extent than prorate. In addition, lemon acreage has declined and this trend is expected to continue. Evidence supports the conclusion that if judiciously applied prorate can have stabilizing and risk-reducing effects which can have a positive impact on efficiency. Therefore, considering all of the factors involved in the marketing of lemons under order No. 910, it is the opinion of the Department that the amendments recommended herein offer the best means of effectuating the intent and purposes of the act i.e., preventing the type of fluctuations in supplies and prices which tend to cause disorderly marketing conditions.

When considering termination of the order or the prorate provisions, one of the issues to be addressed is whether the order or such provisions obstruct or no longer tend to effectuate the declared policy of the act. Among some of the many factors to be considered in addressing this issue are the effects of such termination on the industry as it now exists with current levels of overproduction. Most witnesses felt that, before an equilibrium could be reached between supply and demand, there would be severe economic displacement of grower entities if prorate were discontinued or phased out at this time.

Short term effects would likely be: Drastically increased instability of price and supply; disruption of the farm labor sector; the likelihood of unreliable and more expensive transportation services; instability in both the export and products markets; and the forcing out of the industry of many growers, with the additional expectation that smaller growers with limited financial resources would be affected more than larger growers with more diversified or stronger financial positions. Long term effects were predicted to be a significant decrease in the number of growers, substantially reduced lemon acreage, and shifts in the regional distribution of production. However, growers would be expected to be earning normal rates of return on their lemon investment once an equilibrium was reached. While the long term effects of termination of the order or of prorate could have benefits, the anticipated short term effects, which would result in far reaching permanent changes in the industry, cannot be ignored.

The order with its prorate provisions was originally issued in 1941. At that time the industry was faced with burdensome supplies of lemons relative to demand. The institution of prorate regulations under the order provided a means of correlating supplies with demand and stabilizing the market. The orderly flow of lemons to market benefited both producers and consumers. Prorate provisions continue to be necessary under current market conditions, i.e. overproduction of lemons and static demand. The recommended amendments to the order are considered to be a more appropriate way to effectuate the declared policy of the act than termination of the order or of its prorate provisions.

The Department is not arguing that prorate is a panacea for the solution of overproduction or other marketing problems in the lemon industry. Nor should prorate's cost be allowed to outweigh its benefits as the lemon industry returns to a equilibrium between fresh domestic and export and products markets, when growers would be expected to earn normal returns on their investment. The USDA's Guidelines for Fruit, Vegetable, and Speciality Crop Marketing Orders states, in part, that prorates can be a valuable tool for effective marketing serving the interests of both producers and consumers through market stabilization and extension of the season. The guidelines also state that prorates should be used guardedly so as to avoid stifling individual incentive or overly restricting market supplies. In

AMAA IRFA

The descriptive headings of the various policy terms and conditions are formulated for convenience only and are not intended to affect the construction or meaning of any of the provisions of the contract.

19. Determinations.

All determinations required by the policy will be made by us. If you disagree with our determinations, you may obtain reconsideration of or appeal those determinations in accordance with Appeal Regulations.

20. Notices.

All notices required to be given by you must be in writing and received by your service office within the designated time unless otherwise provided by the notice requirement. Notices required to be given immediately may be by telephone or in person and confirmed in writing. Time of the notice will be determined by the time of our receipt of the written notice.

Done in Washington, DC, on June 28, 1985.

Michael Bosson,

Acting Manager, Federal Crop Insurance Corporation.

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Agricultural Marketing Service

7 CFR Part 978

[Docket No. TVR-PS-1]

Vegetables Grown in Texas; Recommended Decision and Opportunity To File Written Exceptions to Proposed Agreement

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule.

SUMMARY: This recommended decision proposes an agreement which would authorize a coordinated research and promotion type program for vegetables grown in Texas and provides interested persons an opportunity to file written exceptions concerning the recommendations.

The proposed agreement would establish commodity committees consisting of two to eight members and a Texas Vegetable Council consisting of the chairman of each commodity committee, who would handle the local administration of the research and promotion programs. Program costs would be financed by assessments collected only from shippers of vegetables grown for fresh market who voluntarily sign the agreement. There are no provisions for any inspection, grade, size, container or volume regulations. To become effective the proposal would require that the marketing agreement be signed by handlers representing at least 75 percent of a particular vegetable shipped to fresh market from a district.

DATE: Written exceptions to this recommended decision must be received by September 10, 1985.

ADDRESS: Interested persons may file written exceptions to this decision with the Hearing Clerk, Room 1077-S, U.S. Department of Agriculture, Washington, DC 20250. Two copies of all written exceptions should be submitted, and they will be made available for public inspection at the office of the Hearing Clerk during regular business hours.

FOR FURTHER INFORMATION CONTACT: James B. Wendland, Vegetable Branch, Fruit and Vegetable Division, AMS, USDA, Washington, DC 20250, telephone (202) 447-5432.

SUPPLEMENTARY INFORMATION: This administrative action is governed by the provisions of section 556 and 557 of Title 5 of the United States Code and therefore is excluded from the requirements of Executive Order 12291. Prior documents in this proceeding: Pre-notice press release—issued regionally on January 4, 1985; Notice of Hearing—issued February 7, 1985, and published February 11, 1985 (50 FR [illegible]).

Small businesses. The Regulatory Flexibility Act (Pub. L. 96-354), effective January 1, 1981, seeks to ensure that, within the statutory authority of a program, the regulatory and information requirements are tailored to the size and nature of small businesses. Interested persons were invited to present evidence on the probable regulatory and informational impact of the proposed rule on small business at the public hearing.

The record shows all of the witnesses testified that their firms were "small businesses." Also the executive vice president of the Texas Citrus and Vegetable Association testified that a very high proportion of the approximately 120 vegetable industry members of his association would come under the definition of small business. Record evidence documents that the total value of production of Texas vegetables for fresh market averaged approximately $385 million. Using the conservative number of handlers in the Association (which does not include all Texas vegetable handlers) would result in an average value of approximately $3.2 million. This amount is under the $3.5 million volume for small business considered appropriate now for this agricultural service category by officials of the Small Business Administration. It is important to consider that the typical method of doing business is for the terminal market or chain store buyers to remit the proceeds from the sale to the handlers, who in turn remit to the growers a net amount after deducting fees charged for the services of the handlers. Hence, the grower's shares merely pass through the handlers' hands and the handlers' gross receipts represent fees for performing specified services. Thus, very few Texas vegetable handlers would not be classed as small businesses.

The Agricultural Marketing Agreement Act requires the application of uniform rules to regulated handlers. Since signatory handlers that would voluntarily sign the proposed agreement are predominantly small businesses, the program itself is tailored to the size and nature of these small businesses. Other persons would not be bound by the agreement.

Further, while the proposal recommended herein would impose some requirements on the small businesses who sign the agreement and the potential number of such may be approximately 100, any added burden should not be significant, especially in light of the potential benefits that should be derived by such small businesses.

The testimony presented at the hearing on the proposal indicated that the burden of financing and implementing the agreement—should it be put into effect by the Secretary after the 75 percent volume has been signed up—would be no more than the burden of the current non-Federal voluntary promotion program. Rather than reporting and sending assessments to several industry organizations under the agreement signatory handlers might report and send assessments only to the Texas Vegetable Council which would operate under the agreement. This economy of operation would be equally advantageous to large and small businesses, with small business perhaps benefiting to a greater degree in that their operating margins may be smaller.

Additionally, the concept of the agreement itself is particularly beneficial to small businesses. It would authorize large numbers of small businesses to pool their resources to mount a research program or promotional campaign to benefit all such growers and handlers of Texas vegetables. Small businesses are the least likely to be in a position to initiate and maintain the magnitude of a marketing expansion program as foreseen by the proponents of the agreement.

With respect to small businesses that are not Texas vegetable growers or handlers, the impact of the proposed agreement would be different. Some such businesses, including retail food stores, restaurants, and others that sell

Texas vegetables to the public in various forms, could experience increased costs due to the proposed amendment. However, the magnitude of such added costs is difficult to quantify and is speculative. Moreover, these hypothetical added costs would be counterbalanced by the benefits to Texas vegetable growers and handlers and other small businesses, due to increased public awareness and demand for vegetables as a result of promotion and paid advertising projects conducted by the commodity committees.

Preliminary statement. Notice is hereby given of the filing with the Hearing Clerk of this recommended decision with respect to a proposed vegetable research and promotion program covering Texas. The above notice of filing and opportunity to file exceptions to it are issued pursuant to the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 *et seq.*), and in accordance with the applicable rules of practice and procedure governing the formulation of marketing agreements and orders (7 CFR Part 900). Copies of this decision may be obtained from James B. Wendland whose address is listed above.

This proposed agreement was formulated on the record of a public hearing held at San Antonio, Texas, February 20–21, 1985. Notice of the hearing was published in the February 11, 1985, issue of the Federal Register. The notice set forth a proposed marketing agreement submitted by the Texas Vegetable Research and Promotion Steering Committee, listing handlers "representing over 75 percent of Texas acreage of vegetables for fresh market."

Material issues. The material issues presented on the record of the hearing are as follows:

(1) The existence of circumstances which would warrant exercise of Federal jurisdiction in this instance;

(2) The need for the proposed research and promotion type agreement to effectuate the declared policy of the Act;

(3) The definition of the commodities and determination of the area to be affected by the agreement;

(4) The identity of the persons and transactions to be assessed; and

(5) The specific terms and provisions of the proposed agreement including:

(a) Definitions of terms used in it which are necessary and incidential to attain the declared objectives of the Act;

(b) The establishment, maintenance, composition, powers, duties and operation of the commodity committees and the Texas Vegetable Council which shall be the local administrative agencies for this program;

(c) The authority to establish production research, marketing research, consumer education, advertising, market development, product development, and promotion programs, studies, or projects for Texas vegetables;

(d) The authority to incur expenses and to levy assessments on handlers who sign the agreement covering Texas vegetables grown for fresh market;

(e) The establishment of reporting and related recordkeeping requirements; and

(f) Additional terms and conditions as set forth in §§ 978.70–978.94 published in the Federal Register (50 FR 5560) on February 11, 1985, which are necessary to effectuate the provisions of the Act.

Findings and conclusions. The findings and conclusions on the material issues are based upon the evidence presented at the hearing:

(1) Vegetables for fresh market are or can be grown in each of the 254 counties in Texas. In recent years, Texas has consistently ranked third in the United States in fresh market vegetable acreage. From 1981–1983, the harvested acreage of all vegetables in Texas averaged close to 200,000 acres. From this same annual shipments of major fresh vegetables averaging 17.4 million hundredweight.

Each of the numerous fresh vegetables produced in Texas is marketed in the 23 major U.S. cities with Federal-State Market News Service offices. This data for 1983 shows that Texas vegetables are in interstate and foreign commerce by supplying the five reported Canada cities with 368,000 hundredweight and 23 U.S. ones with 8.9 million hundredweight of the vegetables included in the proposed agreement. Additionally, 1983 arrivals in two Texas cities showed 5.15 million hundredweight of out of State vegetables. This data is representative of the shipments to other nonreported cities in the United States. Such vegetables are prepared for shipment in essentially the same manner, whether intended as intrastate or interstate commerce. Also, generally no producer is the sole supplier to a particular market. Because of the market information on prices being paid in competing areas and those offered by competing producers, buyers seek to maximize their returns by buying the quality they are seeking at the lowest prices available anywhere. Conversely, producers seek to maximize their returns by selling their vegetables at the highest available prices. As a result, any shipment or sale of vegetables, whether intrastate, interstate or international, affects prices for all vegetables marketed. The evidence in the record is in accord with the findings in the Act that these products are either in the current of interstate or foreign commerce or directly burden, obstruct, or affect such commerce and except as otherwise provided all such vegetables should be subject to the authority of the Act and the proposed agreement.

(2) The record evidence shows that a program of production research, marketing research, consumer education, advertising, market development, product development and promotion could help the Texas vegetable industry increase its returns and that there is a need for a marketing agreement such as that recommended herein to effectuate the declared policy of the Act.

The maintenance and expansion of existing markets and the development of new markets or uses are vital to the welfare of Texas vegetable producers and shippers and others concerned with marketing and using these vegetables. Record evidence shows it has been difficult to bring about a coordinated program of research and promotion because the industry is composed mainly of small sized businesses spread geographically across the State. Without cooperative action to develop and fund such a program, the industry has been stifled. Record evidence documents several voluntary attempts to provide such projects which were not fully successful because of eventual decline of support and cooperation from the industry. The industry had previously pursued attempting this type activity under the Texas Commodity Referendum Act. However, the Texas Department of Agriculture required that a separate Board would need to be created for each individual vegetable and furthermore separate hearings and referenda would have to be held for each vegetable in each of the 254 counties. The industry deemed such an exceedingly expensive, time consuming and uncoordinated approach to be unworkable, thus a need for this Federal marketing agreement. The latter would provide a more effective self-help type approach where only those who sign the agreement would be assessed to pay program costs and submit needed reports. Record evidence shows all of the witnesses, who consider their firms "small businesses," stressed their support for the program and testified that the proposed reports would pose no additional burden. Most emphasized that, individually, they were not large enough to undertake the research or promotion needed. But through this program they could join together to accomplish the worthy objectives. Thus,

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ilable when requested to do so. In ition, the Commission seeks ments on whether a more specific formance standard for retailers uld be set out in the Rule to ensure t warranties are made available to sumers who request them without easonable delays and whether there uld be other requirements to assist sumers in exercising their rights (e.g., es to publicize the pre-sale ilability of warranties).

The Commission also seeks comment whether Rule 702 should impose on advertisers an obligation to disclose pre-sale availability of warranties in se advertisements that mention rranties. A similar requirement pears in the Commission's revised ides Against Deceptive Advertising Guarantees, 16 CFR Part 239, which being published in the Federal gister contemporaneously with this tice.[7] Disclosures of pre-sale ailability in warranty advertisements uld be required of manufacturers, tailers, or other sellers in order to hance consumer awareness of rranty availability. Comments on this oposal should address, in particular, hether a warranty advertising sclosure requirement would advance e purpose of the Pre-Sale Availability ule by increasing consumer awareness f and access to warranties. Comments hould also consider what effect such dvertising disclosures would have, hat they would cost, and what form of sclosure would have the greatest ffect at the lowest expense.

The FTC additionally seeks comment on whether to include explicit directives in the Rule to require sellers to make television solicitations of mail or telephone order sales to disclose clearly and prominently in such solicitations that warranties are available for examination prior to sale upon request and how they may be obtained. The current Rule does not impose any explicit obligations on sellers with respect to television solicitations of mail or telephone order sales. Section 702.3(c) governs catalogue and mail order sales, but the disclosures required by this section are limited to disclosures in print solicitations. Given the proliferation of product solicitations on television in the last decade, the Commission questions whether it may be necessary to provide explicit directions for television advertisers to use in informing consumers how to obtain copies of their product warranties prior to sale.

Certain revisions are proposed to clarify the Rule's language and organization. First, the FTC proposes to delete the definition of "binder" in § 702.1(g) because under the amendments proposed in this Notice retailers will no longer be required to use binders. Second, the FTC proposes to correct a typographical error by reformulating the definition of "written warranty" in § 7.02.1(c) to clarify that the final clause in that definition modifies both subparts of the definition.

The Commission does not propose any substantive changes in the options available to manufacturers to ensure that warranties are available to retailers because it appears from the staff's investigation that manufacturers have not experienced significant burdens in complying with the present Rule. The Commission is not seeking comments on NMRI's proposal to require manufacturers to affix the warranty to every product package because we believe the upon request proposal to be a more efficient and less burdensome means to achieve pre-sale disclosure of warranty information. If this approach proves unworkable, however, the Commission may consider other alternatives, including NMRI's suggestion that manufacturers shoulder some additional burden.

The Commission has not proposed changes to the Rule provisions concerning mail order, catalogue, and door-to-door sales. The FTC does, however, seek comment on whether Rule 702 should specify how television advertisers of mail or telephone order merchandise should make warranties available to consumers prior to sale. The information gathered during the staff's investigation indicated that these industries have not experienced significant burdens as a result of the Pre-Sale Availability Rule.

C. Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act provides for analysis of the potential impact on small businesses of Rules proposed by federal agencies. *See* 5 U.S.C. 603, 605(b). Staff has researched the composition of the industries affected by the Pre-Sale Availability Rule and has found that a very high percentage of businesses subject to the Rule are "small" based upon Small Business Administration size standards. Unfortunately, the data obtained during the staff investigation do not provide a precise measurement of the economic impact the proposed Rule amendments would have on small businesses. The information gathered does indicate, however, that the proposed changes will have an impact on a large number of small manufacturers and retailers to some degree, by reducing their compliance costs. This section of the Notice of Proposed Rulemaking describes the small businesses which are covered by the Pre-Sale Availability Rule, discusses the compliance measures called for by the proposed amendments to the Rule, and considers whether any alternatives to the proposal could minimize the impact on small businesses.

Commission staff has developed an estimate of the number of small businesses potentially affected by the proposed amendment to the Pre-Sale Availability Rule. Based upon staff's research, nearly all retailers (962,916 companies or 99.3 percent) and manufacturers (11,386 companies or 87 percent) that will be affected by the proposed Rule are considered "small" using the size standards promulgated by the Small Business Administration. If the companies are compared according to annual receipts, small retailers represent approximately 47 percent and small manufacturers represent approximately 23 percent of gross annual receipts in their respective industries.

Staff believes that the proposed amendments to the Rule will reduce retailers' compliance costs by increasing their flexibility to select the disclosure approach that best suits their individual operations. Although the current Pre-Sale Availability Rule gives retailers four options for compliance, staff's investigation showed that most retailers elect the binder options because it is the only one of the four which easily makes use of the copies of warranties submitted by manufacturers. Many retailers complained that the binder option requires allocation of personnel and resources to update and monitor warranty binders, which consumers rarely use. Our store surveys have shown that binders are often difficult for consumers to locate and use because they are incomplete or poorly organized. Thus, although the current Rule attempted to provide flexibility, many retailers have found themselves restricted, in practice, to one approach that is cumbersome and of questionable efficacy.

The industry discussions with FTC staff indicated that larger retail organizations with numerous branch stores compile the binders at a main office and distribute them to their branches. This centralized compliance approach appears to afford lower costs for large retailers, per store, than for a smaller retailer with fewer stores and a decentralized system. The proposed amendment should reduce or eliminate this disparity between large and small enterprises by permitting retailers to replace the binder system with a more flexible approach that conforms to their particular method of doing business.

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[7] The Guides impose this disclosure obligation on sellers whose advertisements mention warranties in order to prevent an inaccurate or deceptive representation of warranty coverage. This Notice asks comment on whether a pre-sale availability disclosure requirement is needed in Rule 702 to further the Rule's goal of widespread consumer access to warranty information.

Staff's discussions with retailers during the investigation indicated that retailers' costs and inconvenience would be reduced if they were not required to maintain warranty binders but could, instead, respond individually to specific consumer requests for warranties. The methods for ensuring that warranties are available when requested would vary according to product and store operation.

We do not anticipate that this proposed amendment to retailers' compliance options will have any impact on large or small manufacturers.

As part of the Commission's evaluation of the Pre-Sale Availability Rule and in response to the Regulatory Flexibility Act, staff has considered alternatives to the proposed amendments that could accomplish the goals of the Magnuson-Moss Warranty Act but minimize the economic impact of small entities. Staff considered a number of alternatives suggested by the Regulatory Flexibility Act including: (1) Different compliance requirements for small businesses, (2) simplification of compliance requirements for small businesses, (3) use of performance rather than design standards in the Rule, and (4) exemption for small businesses.

One of the principal goals of the proposed amendments to the Pre-Sale Availability Rule is to comply with the Congressional mandate in section 102 of the Warranty Act while minimizing the economic impact on all affected businesses. Section 102(b)(1)(A) of the Warranty Act directs the Commission to prescribe a rule requiring that written warranties be made available to consumers prior to sale. All of the alternatives suggested by the Regulatory Flexibility Act have been considered. The third option—use of a performance standard—is at the heart of the proposed Rule. The staff rejected creating an exemption for small businesses because the congressional requirement for presale availability of warranties applies equally to all transactions, regardless of whether they involve a small manufacturer or a small retailer. In addition, staff research into the composition of the affected industries indicates that more than 95 percent of the companies are small. Consequently, it would not be possible to exempt small businesses from the scope of the Rule and at the same time comply with the congressional mandate. Different standards for small businesses were infeasible given the flexible nature of the standards proposed.

Although the proposed amendments are intended to simplify and clarify the measures necessary to comply for all affected companies, small and large, comments received during the Rulemaking may indicate that additional modifications to the Rule are necessary. The Final Regulatory Flexibility Analysis, to be published with the final form of the Rule to be promulgated, will reflect consideration of any additional alternatives proposed during the Rulemaking.

IV. Issues for Comment

The public is invited to submit written comments and data on issues of fact or law relevant to the current Pre-Sale Availability Rule, the proposed amendments, other issues related to making warranties available to consumers prior to purchase, and the issues noted below. Please accompany all submissions of data with a complete report describing the procedures used to gather and analyze the data.

1. Will the proposed amendments to § 702.3(a) create significant disincentives or obstacles to consumers who wish to obtain warranty information prior to purchase?

a. What systems and procedures would retailers use to provide warranties to consumers if retailers were required to make warranties "readily available" upon request?

b. What information is now available to indicate the practical obstacles this option would present for consumers (*i.e.*, how long they must wait for production of the warranty, how often they must request it, how many offices or store personnel they must visit to receive it)?

2. a. Are the standards for compliance in the proposed amendments to § 702.3(a) clear? If not, what are the ambiguities and how can they be clarified?

b. Is there a need for the Commission to consider more specific performance standards to define compliance with an availability upon request requirement (*i.e.*, requiring that warranties be provided without undue delay or without substantial effort on the part of consumers who request warranties)? What form could such standards take? What are the benefits, costs and drawbacks of imposing such standards?

3. How will the proposed revision of § 702.3(a) of the Pre-Sale Availability Rule affect compliance costs for retailers and manufacturers?

4. What other modifications to the Rule specifying methods for the disclosure of warranty information by retailers would reduce overall compliance costs and still ensure consumers access to warranties prior to purchase?

5. Should the Commission include, as part of an on-request warranty availability requirement, provisions requiring retailers and/or advertisers to publicize the pre-sale availability of warranties and to inform consumers how to take advantage of this right (*i.e.*, through signs in retail outlets, or disclosures in advertisements that mention warranties)? What effect would these forms of publicity have, how would they benefit consumers, and what would they cost?

6. Should the Commission include explicit directives in § 702.3(c) of the Rule to require sellers who make television solicitations of mail or telephone order sales to disclose clearly and prominently in such solicitations that warranties are available for examination upon request and to disclose how they may be obtained?

List of Subjects in 16 CFR Part 702

Trade practices, Warranties.

Authority: 15 U.S.C. 2302 and 2309.

PART 702—[AMENDED]

It is proposed that 16 CFR Part 702 be amended as set forth below:

§ 702.1 [Amended]

1. It is proposed that 16 CFR 702.1(c) be amended to read as follows:

(c) "Written warranty" means—(1) any written affirmation of fact or written promise made in connection with the sale of a consumer product by a supplier to a buyer which relates to the nature of the material or workmanship and affirms or promises that such material or workmanship is defect free or will meet a specified level of performance over a specified period of time, or

(2) any undertaking in writing in connection with the sale by a supplier of a consumer product to refund, repair, replace or take other remedial action with respect to such product in the event that such product fails to meet the specifications set forth in the undertaking,

which written affirmation, promise, or undertaking becomes part of the basis of the bargain between a supplier and a buyer for purposes other than resale of such product.

2. It is proposed that 16 CFR 702.1(g) be removed.

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or sales of the securities to be distributed."

As the Commission has noted previously, the formulation with respect to other securities in essence requires a cooling-off period of nine business days.[illegible] The Commission believes that the current formulation of the cooling-off period in Exceptions (xi)(C) and (xii)(C) is archaic, inconsistent with the formulation of the other cooling-off periods in the Exceptions, and may be confusing to persons affected by the Rule.[illegible]

Accordingly, the Commission proposes to reformulate Exceptions (xi)(C) and (xii)(C) to conform them to the clearer language used in the other cooling-off periods in Exceptions (xi) and (xii).

III. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with the provisions of the Regulatory Flexibility Act (5 U.S.C. 603), and concerns the effect of proposed amendments to Rule 10b-6 on small entities. At this time the Commission is unable to determine the costs to small entities of complying with the proposed amendments to Rule 10b-6. However, the Commission believes that, if there is a "significant economic impact on a substantial number of small entities," this impact will not be adverse, since the primary thrust of the proposed amendments is to clarify the application of Rule 10b-6, codify existing Commission positions, and lessen the restrictions of Rule 10b-6 in a number of circumstances. Nevertheless, this analysis was prepared because of the uncertainty concerning the effects of the proposed amendments on small entities.

A. Reasons for Proposed Action

Rule 10b-6 is an anti-manipulative rule that, subject to certain exceptions, prohibits persons who are engaged in a distribution of securities from, directly or indirectly, bidding for or purchasing, or inducing other persons to purchase, such securities, any security of the same class and series as those securities, or any right to purchase any such security, until they have completed their participation in the distribution. The purpose of the Rule is to prevent participants in a distribution from artificially conditioning the market for the securities in order to facilitate the distribution. The Rule is designed to protect the integrity of the securities trading market as an independent pricing mechanism and thereby enhance investor confidence in the marketplace.

Rule 10b-6 was adopted in 1955 and in large measure codified principles established in prior administrative interpretations and proceedings concerning trading activity in connection with distribution securities. Since its adoption, Rule 10b-6 has been and continues to be an important means of ensuring that the marketplace is free from manipulative activities during a distribution of securities. In 1983 the Commission adopted comprehensive amendments that were designed to accommodate the Rule, to the extent consistent with its anti-manipulative purposes, to the significant changes in the structure and operation of the securities markets, in offering techniques, and in business needs and practices that had occurred since the Rule's adoption.

The Commission has had the opportunity to further examine Rule 10b-6, gain experience with the operation and impact of the 1983 Amendments, and evaluate further developments in the securities markets. The Commission believes that certain additional amendments to the Rule are appropriate at this time.

B. Objectives

If adopted, these amendments would: permit underwriters and broker-dealers involved in a distribution of securities to engage in solicited brokerage transactions until two or nine business days before offers or sales of the securities being distributed; define the applicability of the Rule to certain persons who are affiliated with issuers, underwriters, brokers, dealers, and others participating in a distribution; reduce the restrictions on the exercise of standardized call options by distribution participants; and provide a parallel formulation of the cooling-off periods within Exceptions (xi) and (xii) of the Rule. *Additionally*, the amendments would expand the Rule's preamble to more fully reflect the authority for the provisions of the Rule, and codify the Commission's position that a distribution participant may rely on the Rule's exceptions only if the contemplated transactions are not made for manipulative purposes.

C. Legal Basis

The proposed amendment would be promulgated pursuant to Sections 2, 3, 9(a)(6), 10(b), 13(e), 15(c) and 23(a) of the Exchange Act (15 U.S.C. 78b, 78c, 78i(a)(6), 78j(b), 78m(e), 78o, and 78w(a)).

D. Small Entities Subject to the Rule

The proposed amendments have the potential to affect all small businesses that anticipate a public offering, all small broker-dealers that participate in the distribution of securities, and some small organizations affiliated with these entities. Rule 157 under the Securities Act defines the terms "small business" and "small organization" as any issuer, other than an investment company, whose total assets on the last day of its most recent fiscal year were $3 million or less and that is engaged in small business financing, *i.e.*, any issuer that engages in or proposes to engage in the offer and sale of its securities that does not exceed the dollar limitations (currently $5 million) prescribed in section 3(b) of the Securities Act. Rule 0-10(c) under the Exchange Act defines the term "small business" or "small organization" as a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter), and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

During 1984, about [illegible] small businesses engaged in public offerings of less than $5 million. During the same period, about [illegible] small broker-dealers participated in underwritings. The Commission is unable to determine the number of small entities which were affiliated with these small issuers and broker-dealers and which would have been affected by the proposed amendments had they been in place. At this time the Commission is unable to determine the costs to small entities of complying with the proposed amendments to Rule 10b-6. However, the Commission believes that, if there is a "significant economic impact on a substantial number of small entities," any adverse impact is outweighed by the primary thrust of the proposed amendments, which is to clarify the application of Rule 10b-6, codify existing commission positions, and lessen the restrictions of Rule 10b-6 in a number of circumstances.

[illegible] 1983 Adopting Release, 48 FR at [illegible] n.[illegible].

[illegible] The Commission understands that many securities practitioners refer to the cooling-off period in Exceptions (xi)(C) and (xii)(C) as the "nine business day period."

E. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would not impose any additional reporting, recordkeeping, or other compliance requirements.

F. Overlapping or Conflicting Federal Rules

Rule 10b-6 supplements more general antifraud and antimanipulation provisions such as section 9(a)(2) and section 10(b) of the Exchange Act and Rule 10b-5 thereunder. There are no conflicting federal rules.

G. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives to the proposal that would accomplish the stated objectives while minimizing any significant adverse economic impact on small entities. The Commission does not believe that the proposed amendments will have an adverse impact on small entities, since the primary thrust of the proposed amendments is as described above. The Commission considered alternative proposals, including those discussed below, but does not believe that such alternative approaches would be consistent with the Commission's statutory mandate of investor protection.

The Commission considered whether the fiduciary obligations of certain affiliates of distribution participants are sufficient protection against manipulative activity and that, therefore, those affiliates should be excepted from the operation of Rule 10b-6. The Commission determined, however, that such an approach would not afford adequate protection for the very significant interests of investors in the integrity of the securities trading market. With respect to call options, the Commission considered and rejected a formulation of the cooling-off period for standardized options parallel to those provided within Exceptions (xi) and (xii). It is the Commission's belief that a two-day cooling-off period would be counter-productive since purchases of securities in response to such options exercises would be likely to occur contemporaneously with the commencement of offers and sales in the distribution of the underlying security. Instead, the Commission has proposed two alternatives in an effort to derive the broadest relief consistent with the overriding considerations of investor protection.

H. Conclusion

The Commission encourages the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. Based upon these preliminary evaluations of the possible compliance costs and effects upon competition and after receipt of any comments from interested persons, it may be appropriate to conclude that the proposal does not have a significant economic impact on a substantial number of small entities. Comments received will be considered in the preparation, if required, of a Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted.

IV. Solicitation of Comments

All interested persons are invited to submit written data, views, and arguments concerning the foregoing, including the Initial Regulatory Flexibility Analysis. Persons desiring to make submissions should submit three copies thereof to John Wheeler, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, not later than December 23, 1985. Reference should be made to File No. S7-42-85. All submissions, including any on the Initial Regulatory Flexibility Analysis, will be placed in File No. S7-42-85 and will be made available for public inspection at the Commission's Public Reference Section, Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities, Issuers, Broker-dealers, Fraud.

V. Statutory Basis and Text of Proposed Amendments

Pursuant to sections 2, 3, 9(a)(6), 10(b), 13(e), 15(c) and 23(a) of the Exchange Act, 15 U.S.C. 78b, 78c, 78i(a), 78j(b), 78m(e), 78o(c), 78w(a), the Commission proposes to amend § 240.10b-6 of Chapter II of Title 17 of the Code of Federal Regulations to read as follows:

Note.—Arrows indicate text proposed to be added. Brackets indicate text proposed to be removed.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 is amended by adding the following citation, and the authority citation following section 240.10b-6 in Part 240 is removed.

Authority: Sec. 23, 48 Stat. 901, as amended, 15 U.S.C. 78w, * * * § 240.10b-6 also issued under secs. 2, 3, 9(a)(6), 10(b), 13(e), 15(c); 15 U.S.C. 78b, 78c, 78i(a), 78j(b), 78m(e), 78o(c) * * *

2. By revising paragraphs (a) introductory text, (a)(1), (a)(3) introductory text, (a)(3)(v), (a)(3)(vii), (a)(3)(xi), (a)(3)(xii), and (c)(6) of § 240.10b-6 to read as follows:

§ 240.10b-6 Prohibitions against trading by persons interested in a distribution.

(a) It shall [constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act] ▸be unlawful◂ for any person,

(1) Who is an underwriter or prospective underwriter in a particular distribution of securities, ▸or who is an affiliated purchaser, as that term is defined in paragraph (c)(6) of this section,◂ or

* * * * *

(3) Who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, ▸or who is an affiliated purchaser of such broker, dealer, or other person, as that term is defined in paragraph (c)(6) of this section,◂ directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right until after he has completed his participation in such distribution: *Provided, however,* That ▸, if not engaged in for the purpose of creating actual, or apparent, active trading in or raising or maintaining the price of any such security,◂ this section shall not prohibit:

* * * * *

(v) Brokerage transactions▸:

(A) not involving solicitations of the customer's order, or

(B) involving solicitation of the customer's order (*1*) in the case of securities qualified under paragraph ▸(c)(7)◂(i)(A) of this section, prior to the later of two business days before the commencement of offers or sales of the securities to be distributed or the time the broker-dealer becomes a participant in the distribution, or (*2*) in the case of other securities, prior to the later of nine business days before the commencement of offers or sales of the securities to be distributed or the time

H.R. 3036 PL 99-190

National Security Council

SALARIES AND EXPENSES

For necessary expenses of the National Security Council, including services as authorized by 5 U.S.C. 3109; $4,627,000.

Office of Management and Budget

SALARIES AND EXPENSES

For necessary expenses of the Office of Management and Budget, including hire of passenger motor vehicles, services as authorized by 5 U.S.C. 3109; ~~$37,689,000~~ *$36,909,000*: *Provided,* That none of the funds appropriated in this Act for the Office of Management and Budget may be used for the purpose of reviewing any agricultural marketing orders or any activities or regulations under the provisions of the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. 601 et seq.)~~: *Provided further,* That none of the funds made available for the Office of Management and Budget by this Act may be expended for the review of the transcript of actual testimony of witnesses, except for testimony of officials of the Office of Management and Budget, before the Committee on Appropriations or the Committee on Veterans' Affairs or their subcommittees: *Provided further,* That this proviso shall not apply to printed hearings released by the Committee on Appropriations or the Committee on Veterans' Affairs~~.

*Public Law 99-190
99th Congress

Joint Resolution

Making further continuing appropriations for the fiscal year 1986, and for other purposes.

Dec. 19, 1985
[H.J. Res. 465]

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the following sums are hereby appropriated, out of any money in the Treasury not otherwise appropriated, and out of applicable corporate or other revenues, receipts, and funds, for the several departments, agencies, corporations, and other organizational units of the Government for the fiscal year 1986, and for other purposes, namely:

SEC. 101. (a) Such amounts as may be necessary for programs, projects, or activities provided for in the Agriculture, Rural Development, and Related Agencies Appropriations Act, 1986 (H.R. 3037), to the extent and in the manner provided for in the conference report and joint explanatory statement of the Committee of Conference (House Report Numbered 99-439), as filed in the House of Representatives on December 12, 1985, as if such Act had been enacted into law.

Notwithstanding any other provision of this Joint Resolution, each appropriation item in the referenced bill (H.R. 3037) made available under this subsection may be reduced by six-tenths of 1 per centum, if applied to every appropriation item, rounded to the nearest thousands of dollars, except for the following appropriations: Child Nutrition Programs and Special Milk Program which are true entitlements: *Provided,* That such reductions, if made, shall be applied proportionally to each program, project, and activity as set forth in the conference agreement (H. Rept. 99-439).

(b) such amounts as may be necessary for programs, projects or activities provided for in the Department of Defense Appropriations Act, 1986, at a rate of operations and to the extent and in the manner provided as follows, to be effective as if it had been enacted into law as the regular appropriation Act:

Infra.

AN ACT

Making appropriations for the Department of Defense for the fiscal year ending September 30, 1986, and for other purposes.

Department of Defense Appropriations Act, 1986.

TITLE I

MILITARY PERSONNEL

MILITARY PERSONNEL, ARMY

For pay, allowances, individual clothing, subsistence, interest on deposits, gratuities, permanent change of station travel (including

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*Note: The printed text of Public Law 99-190 is a reprint of the hand enrollment, signed by the President on December 19, 1985.

Senate Amendment Numbered 188 as amended by the House of Representatives.

Ante, p. 1072.

(g) For the purposes of Sec. 252(a)(6)(D)(i)(II) of Public Law 99-177, the section of the Statement of the Managers entitled "Definition of Program, Project, and Activity as provided by Public Law 99-177, the Balanced Budget and Emergency Deficit Control Act of 1985" shall be considered to be the reports filed by the Committees on Appropriations for the purpose of defining "Program, Project, and Activity".

(h) Such amounts as may be necessary for programs, projects, or activities provided for in the Treasury, Postal Service, and General Government Appropriations Act, 1986 (H.R. 3036), to the extent and in the manner provided for in the conference report and joint explanatory statement of the committee of conference (House Report 99-349) as passed by the House of Representatives and the Senate on November 7, 1985, as if enacted into law except that such conference report shall be considered as not including Senate Amendment Numbered 83 as amended by the Conferees: *Provided*, That appropriations made by this joint resolution for the following accounts shall not exceed: $1,065,000,000 for "Internal Revenue Service, processing tax returns"; $1,419,451,000 for "Internal Revenue Service, examinations and appeals"; and $748,000,000 for "Payment to the Postal Service Funds".

(i) Such amounts as may be necessary for projects or activities provided for in the Foreign Assistance and Related Programs Appropriations Act, 1986, at a rate for operations and to the extent in the following Act; this subsection shall be effective as if it had been enacted into law as the regular appropriation Act:

Post, p. 1315.

AN ACT

Making appropriations for foreign assistance and related programs for the fiscal year ending September 30, 1986, and for other purposes, namely:

TITLE I—MULTILATERAL ECONOMIC ASSISTANCE

FUNDS APPROPRIATED TO THE PRESIDENT

International Financial Institutions

CONTRIBUTION TO THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

For payment to the International Bank for Reconstruction and Development by the Secretary of the Treasury, for the United States share of the paid-in share portion of the increase in capital stock, $109,720,549 for the General Capital Increase, as authorized by section 39 of the Bretton Woods Agreements Act, as amended (Public Law 79-171), to remain available until expended: *Provided*, That no such payment may be made while the United States Executive Director to the Bank is compensated by the Bank at a rate in excess of the rate provided for an individual occupying a position at level IV of the Executive Schedule under section 5315 of

22 USC 286e-1h.

Prices and Shipments During Prorate and Prorate Suspension for the California–Arizona Navel Orange Federal Marketing Order

by

Nicholas J. Powers*

Abstract: In the midst of the 1984/85 marketing season, with navel orange prices exceeding parity due to a short crop, the handler prorate provision of the Federal marketing order for California–Arizona navel oranges was suspended for the remainder of the season. Standard statistical tests were used to determine whether there were any significant differences between the average level and variation of navel orange prices and shipments between the prorate suspension period and the prorated periods. The analysis indicated that during the suspension, observed in a season with short navel orange supplies, average prices at f.o.b., wholesale, and retail were greater and statistically significant. Wholesale prices were less variable in New York City, Chicago, and Los Angeles and significantly less variable in New York and Chicago, but there was no consistent pattern of increasing or decreasing price variability at other points in the marketing channel. During the suspension average weekly fresh domestic shipments were slightly greater but not statistically significant, and average weekly export shipments were slightly less but not statistically significant. Average weekly processing shipments were less and statistically significant. The variability of weekly shipments was also less for fresh domestic, export, and processing markets, but statistically significant only for processing. The analysis limited to one season with short supplies should not be used to infer the effects of a prorate suspension under normal supplies and/or longer duration.

Keywords: Marketing orders, handler prorate suspension, prices, shipments, California–Arizona navel oranges.

Introduction

The Agricultural Marketing Agreement Act of 1937 (AMAA), as amended, allows growers of selected commodities to collectively market their products in interstate commerce. The intent of the AMAA is to improve the coordination of supply and demand, thus promoting stability and enhancing grower returns toward parity.

Federal Marketing Order No. 907 for California–Arizona navel oranges was approved in 1953. This order authorizes handler prorates, size standards, and marketing research. The handler prorate is a volume control provision designed to regulate the quantity of navel oranges entering the fresh domestic market (the continental U.S. and Canada) each week. Management of weekly shipment flows is intended to provide continuity and stability of intraseasonal shipments and prices.

In the midst of the 1984/85 season, with navel orange prices exceeding parity because of short fresh orange supplies and the freeze in Florida and Texas, the Secretary of Agriculture suspended the handler prorate provision for the remainder of the season.1/ The suspension was controversial. Some industry members argued it would cause erratic navel orange prices and shipments. Several consumer organizations argued that the suspension would increase fresh domestic shipments and, consequently, lower navel orange prices.

Standard statistical tests were used to determine whether there were any significant differences between the average level and variation of navel orange prices and shipments between the prorate suspension period and the prorated periods.2/ The analysis does not determine income effects of the suspension, nor does it determine the value of prices and shipments had there not been a suspension.

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Data Description

The data for the analysis were for the weeks following the prorate suspension (February 7) during the 1984/85 season and two periods when the prorate was in effect. The two prorate periods were the 1979/80–1983/84 and 1981/82 seasons. Average fresh orange supplies during the 1979/80–1983/84 period are representative of normal supplies (table 1). Although total fresh orange supplies were 15 percent greater, the short navel orange supplies during 1981/82 were closer to the 1984/85 season. Significant differences in the average level and variation of prices and shipments during the 1984/85 and 1979/80–1983/84 periods were probably due to several factors, including different navel orange supplies, competing fresh orange supplies, and the suspension.

Before beginning the discussion of the statistical results for significant differences in the level and variation of prices and shipments, it is important to have an idea of the general magnitude of the levels and variation of prices and shipments during the various periods. The level and variation of deflated fresh and processing monthly prices were greater during the suspension period than during either prorated periods (table 2). Also, during the suspension, the average weekly industry shipment to the fresh domestic market was greater and its variation was smaller; the average and variation of weekly industry fresh export and processing shipments were less. The statistical analysis, discussed in the next section, provides a more formal procedure to determine whether these observed differences in the levels and variation of prices and shipments were statistically significant.

For the statistical tests to indicate the impact of the prorate suspension, the suspension and prorated periods must be otherwise identical. Because of short orange supplies, among other factors during 1984/85, the suspension and prorated periods are not identical. Consequently, it is difficult to fully assess the impacts of the suspension. To complicate the problem, the statistical tests used are conditional on several assumptions which are seldom fully satisfied.3/

Table 1.—U.S. fresh orange supplies during the winter seasons of the prorated periods, 1979/80–1983/84 and 1981/82, and the prorate suspension period, 1984/85

Period	Crop	Quantity 1/
		(100,000 lbs.)
Prorated		
1979/80–1983/84	California-Arizona navels	26,726
	Florida early, navels, and mid-season	5,075
	Texas	2,207
	U.S.	34,008
1981/82	California-Arizona navels	20,804
	Florida early, navels, and mid-season	4,436
	Texas	2,822
	U.S.	28,062
Prorate suspension		
1984/85	California-Arizona navels	20,317
	Florida early, navels, and mid-season	3,976
	Texas	0
	U.S.	24,293

1/ Data from the Statistical Reporting Service, USDA.

Table 2.—California-Arizona navel oranges: Means and standard deviations of prices and shipments during prorated periods of 1979/80–1983/84 and 1981/82, and during the prorate suspension period of 1984/85 1/

Variable	Unit 2/	Period	Mean	Std. dev.
Deflated fresh f.o.b. price 3/	$/carton	1979/80–1983/84	3.93	2.34
		1981/82	5.68	2.42
		1984/85	8.48	2.66
Deflated processing f.o.b. price 3/	$/carton	1979/80–1983/84	-0.42	0.61
		1981/82	-0.76	1.12
		1984/85	1.01	0.36
Fresh domestic shipments 4/	1,000 cartons	1979/80–1983/84	1,230	730
		1981/82	1,268	818
		1984/85	1,332	696
Fresh export shipments 4/	1,000 cartons	1979/80–1983/84	156	121
		1981/82	144	110
		1984/85	126	98
Processing shipments 4/	1,000 cartons	1979/80–1983/84	758	485
		1981/82	438	287
		1984/85	280	175

1/ Data are for the period subsequent to the effective prorate suspension to the end of the season. 2/ Carton = 37-1/2 pounds. 3/ Monthly prices by the Statistical Reporting Service and deflated by the index of prices received by farmers for all farm commodities, 1977=100. 4/ Weekly shipment data from the Navel Orange Administrative Committee.

Empirical Findings

Prices

Prices were collected at five levels in the navel orange distribution channel. Monthly California fresh and processing estimated-on-tree (e.o.t.) and packinghouse-door (p.h.d.) navel orange prices reflected grower prices before and after picking. Free-on-board (f.o.b.) prices reflected handler selling prices from the major navel orange-producing areas—southern and central California. Midweek f.o.b. prices were further disaggregated into first and choice grades, the two major grades of fresh navel oranges, and by the major fruit sizes—56 (large), 72, 88, and 113 (small). Midweek prices for first grade fresh navel oranges sizes 48 through 113, were from three major regional wholesale markets—New York City, Chicago, and Los Angeles. Monthly retail prices were for all fresh navel oranges sold in the United States. Retail prices were deflated by the Consumer Price Index for food; wholesale prices were deflated by the Wholesale Price Index for fresh fruits and vegetables; and f.o.b., p.h.d., and e.o.t. prices were deflated by prices received by farmers for all commodities.

The test results, using the 1979/80–1984/85 data (table 3, column 5), indicate that for all of the 32 price series analyzed, average prices were greater during the suspension and 27 were significantly greater. However, greater average prices during the suspension were likely a consequence of the small California-Arizona navel orange crop and the Florida and Texas fresh orange crops of 1984/85, and not because of the suspension.

A comparison of average central California f.o.b. shipper prices, using data from the short-crop 1981/82 and 1984/85 seasons (table 4, column 5), indicates that navel orange prices were higher following the suspension in 1984/85 than during the corresponding prorate period in 1981/82. The higher prices during 1984/85 were probably not related to the suspension, but rather to the smaller supplies of competing fresh oranges (table 1). The results suggest that a suspension with a short crop similar to that of 1984/85 would probably not depress prices.

Overall, the price variability observed during the suspension is mixed and dependent on the specific level in the food distribution channel. The findings, using the 1979/80–1984/85 data (table 3, column 6), suggest that wholesale prices were more stable (only significant in three of the six price series) during the suspension. However, the results of the f.o.b. shipper, p.h.d., and e.o.t. price series were inconclusive. The findings, using the single available f.o.b. price series for 1981/82 and 1984/85 (table 4, column 6), indicate statistically significant

Table 3.—Comparison of average and variability in California-Arizona navel orange prices: 1984/85 prorate-suspension period and comparable 1979/80–1983/84 period

Price series 1/	Use	Grade	Fruit size	Deflated price 2/	
				Average	Variability
Retail	Fresh	—	—	S*	S
New York City, wholesale	Fresh	First	(48–113)	S*	P*
Chicago, wholesale	Fresh	First	56	S	P*
			72	S*	P
			88	S*	P
			113	S*	P
Los Angeles, wholesale	Fresh	First	(56–113)	S*	P*
California, f.o.b.	Fresh			S*	S*
Central California, f.o.b.	Fresh	First	56	S*	P
			72	S*	P
			88	S*	S*
			113	S*	S
			138	S*	P
Southern California, f.o.b.	Fresh	First	56	S*	P*
			72	S*	P*
			88	S*	P*
			113	S*	P*
			138	S*	P*
Central California, f.o.b.	Fresh	Choice	56	S*	S
			72	S*	S*
			88	S*	S*
			113	S*	S*
			138	S*	S
Southern California, f.o.b.	Fresh	Choice	56	S	P*
			72	S*	P
			88	S	P*
			113	S	P*
			138	S	P*
California, p.h.d.	Fresh			S*	S
California, p.h.d.	Processing			S*	P
California, e.o.t.	Fresh			S*	S
California, e.o.t.	Processing			S*	S

1/ Sources monthly retail prices, the Bureau of Labor Statistics; midweek wholesale prices for New York City, Chicago, and Los Angeles, Federal-State Market News Service; monthly California free-on-board (f.o.b) prices, Statistical Reporting Service; midweek central California and southern California free-on-board (f.o.b.) prices, Statistical Reporting Service; monthly California packinghouse-door (p.h.d.) and equivalent-on-tree (e.o.t.) prices, Statistical Reporting Service. 2/ The "P" or "S" indicates whether average prices or variance of price during the respective prorate or prorate suspension period were greater. An asterisk ("*") with a "P" or "S" indicates whether average prices or variance of price during the prorate or prorate suspension period, respectively, were significantly greater at the 5-percent level.

Table 4.—Comparison of average and variability in California-Arizona navel orange prices: 1984/85 prorate-suspension period and comparable 1981/82 period

Price series 1/	Use	Grade	Fruit size	Deflated price 2/	
				Average	Variability
Central California, f.o.b.	Fresh	First	56	S*	S*
			72	S*	S*
			88	S*	S*
			113	S*	S*
			138	S*	S*

1/ Midweek central California and southern California free-on-board (f.o.b.) prices from the Statistical Reporting Service. 2/ The "P" or "S" indicates whether average prices or variance of price during the respective prorate or prorate suspension period were greater. An asterisk ("*") with a "P" or "S" indicates whether average prices or variance of price during the prorate or prorate suspension period, respectively, were significantly greater at the 5-percent level.

greater price variability (significant in all five cases) during the suspension.

Shipments

Weekly navel orange shipments into the fresh domestic, fresh export, and processing markets for districts 1 (central California), 2 (southern California), and 4 (northern California), and for the entire industry were analyzed for effects during the suspension.4/ The results of the average and variability tests for navel orange shipments are summarized in tables 5 and 6, respectively.

Average weekly shipments into the fresh domestic market, the major fresh utilization channel, were greater, while those into the processing market were significantly lower during the suspension than during the 1979/80–1983/84 prorate period (table 5, column 3). Although average weekly fresh domestic shipments were greater during the suspension, in none of the cases were the results significant. The average weekly fresh export, the minor fresh utilization channel, and processing shipments were less (significant in four of six cases) during the suspension.

The test results, using the 1981/82 and 1984/85 shipment data (table 6, column 3) for the industry and for district 1 (the major producing area) are consistent with the preceding findings. However, the results were not consistent in district 2, a minor producing area.

Test results, using both the 1979/80–1984/85 data (table 5, column 4) and 1981/82 and 1984/85 data (table 6, column 4), indicate that the variability in weekly fresh domestic, fresh export, and processing shipments tended to be greater (9 of 18 cases were significant) during the prorate. During the suspension, weekly shipments into the three utilizations were more stable.

Summary and Conclusion

The higher average California-Arizona navel orange price following the 1984/85 prorate suspension, compared with the average price during the 1979/80–1983/84 prorated period, is attributed largely to the short navel orange supply and limited quantities of competing fresh oranges during the season.

A comparison of weekly California-Arizona navel orange price variation during the suspension with those during both previous prorated periods suggests that the average weekly wholesale price was more stable during the suspension. The stability of prices at other levels of the marketing channel were not significantly different following the suspension.

California-Arizona navel orange average weekly shipments for processing during the suspension, compared to those during previous prorated periods declined significantly, while fresh domestic shipments increased (but not significantly), and fresh export shipments decreased (but not significantly). The weekly variability of fresh domestic, export, and processing shipments was greater during the previous prorated periods than during the suspension.

Overall, the analysis indicated that during the suspension, observed in a season with short navel orange supplies, average prices at f.o.b., wholesale, and retail were greater and statistically significant. Wholesales prices were less variable in New York City, Chicago, and Los Angeles and significantly less variable in New York City and Chicago, but there was no consistent pattern of increasing or decreasing price variability at other points in the marketing channel. During the suspension average weekly fresh domestic shipments were slightly greater but not significant and average weekly export shipments were slightly less but not statistically significant. Average weekly processing shipments were less and statistically siginificant. The variability of weekly shipments was also less for fresh domestic, export, and processing markets, but statistically significant only for processing.

The analysis in this paper is based on a limited-duration prorate suspension with short supplies of navel and other oranges. Consequently, the analysis should not be used to infer the price and shipment effects of a suspension under normal navel orange supplies or longer duration, or both. The price and shipment effects of a suspension with normal orange supplies or a suspension of longer duration may or may not differ from those identified for the 1984/85 prorate suspension. Of interest to the navel orange industry, consumers, and policymakers would be an analysis identifying the direction and magnitude of long-term navel orange price, shipment, and market structure changes with a continuation in a handler prorate suspension.

Footnotes

1. In recent years, it has been the Department of Agriculture's policy to suspend the handler prorate provision after 80 percent of the navel orange crop had been marketed. At the time the 1984/85 prorate suspension became effective, 48 percent of the crop remained to be marketed. Thus, the 1984/85 season marked the first occasion since the inception of the order that a relatively large percentage of the crop was marketed without prorate.

2. The statistical test for testing the null hypothesis that the variances of two normally distributed random variables are equal is:

$$F(N^P-1,N^S-1) = \frac{V(X^P)}{V(X^S)} \text{ if } V(X^P) > V(X^S) \text{ or}$$

$$F(N^S-1,N^P-1) = \frac{V(X^S)}{V(X^P)} \text{ if } V(X^S) > V(X^P)$$

Where: F is the calculated F-test; $N^P$and N^S are the number of observations in the prorate and prorate suspension periods; $V(X^P)$ and $V(X^S)$ are the variances of the random variable during the prorate and prorate suspension periods.

If the variances of the two variables are not significantly different then the appropriate statistical test for testing the null hypothesis that the means of two normally distributed variables are equal is:

$$t(N^S+N^P-2) = \frac{(N^S+N^P-2)^{1/2}}{\left(\frac{1}{N^S}+\frac{1}{N^P}\right)^{1/2}}$$

$$\frac{(\bar{\bar{X}}^S-\bar{\bar{X}}^P)}{(SSR(X^S)+SSR(X^P))^{1/2}}$$

Where: t is the calculated t-test; X^P and X^s are the means of the random variables during the prorate and prorate suspension periods; $SSR(X^P)$ and $SSR(X^S)$ are the sum of squared residuals of the random variables during the prorate and prorate suspension periods.

The statistical test used for testing the null hypothesis that the means of two normally distributed random variables are equal when the variances of the two random variables are significantly different is:

$$t(N^S+N^P-2) = \frac{(N^S+N^P-2)^{1/2}}{\left(\frac{1}{N^S} + \frac{K}{N^P}\right)^{1/2}} \quad \frac{(\bar{X}^S-\bar{X}^P)}{(SSR(X^S) + SSR(X^P/K))^{1/2}}$$

Where: $K = SSR(X^P) / SSR(X^S)$, $K > 0$.

Reference: DeGroot, Morris H.,
Probability and Statistics,
Addison-Wesley Publishing Co., Inc., 1975.

3. The F and t-tests used in the analysis assume that the observations in each period are statistically independent of each other, have equal variance, and have a normal (bell-shaped) distribution. The values of test results could be significantly affected if these assumptions are not met. For example, time series data are typically not strictly independent (autocorrelated). However, various graphs and measures of independence (autocorrelation) of the price and shipment data used in the analysis did not indicate any pronounced dependencies.

4. The effects of the prorate suspension on district 3 (Arizona) shipments are not considered because, when the prorate suspension became effective, district 3 had completed its marketing of navel oranges.

Table 5.--Comparison of average and variability in California-Arizona navel orange shipments: 1984/85 prorate-suspension period and comparable 1979/80-1983/84 period

Shipment series 1/		Shipment 2/	
		Average	Variability
Industry			
	Fresh domestic	S	P
	Export	P	P
	Processing	P*	P*
District 1			
	Fresh domestic	S	P
	Export	P*	P*
	Processing	P*	P*
District 2			
	Fresh domestic	S	P
	Export	P	S
	Processing	P*	P*
District 4			
	Fresh domestic	P	P*
	Exports	—	—
	Processing	—	—

1/ Weekly shipment data are from the Navel Orange Administrative Committee. 2/ The "P" or "S" indicates whether average weekly shipments or variance of weekly shipments during the respective prorate or prorate suspension period were greater. An asterisk ("*") with a "P" or "S" indicates whether average weekly shipments or variance of weekly shipments during the prorate or prorate suspension period, respectively, were significantly greater at the 5-percent level.

Table 6.—Comparison of average and variability in California-Arizona navel orange shipments: 1984/85 prorate-suspension period and comparable 1981/82 period

Shipment series 1/		Shipment 2/	
		Average	Variability
Industry			
	Fresh domestic	S	P
	Export	P	P
	Processing	P*	P*
District 1			
	Fresh domestic	S	P
	Export	P*	P*
	Processing	P*	P*
District 2			
	Fresh domestic	P	S*
	Export	S	
	Processing	S	P
District 4			
	Fresh domestic	—	—
	Export	—	—
	Processing	—	—

1/ Weekly shipment data are from the Navel Orange Administrative Committee. 2/ The "P" or "S" indicates whether average weekly shipments or variance of weekly shipments during the respective prorate or prorate suspension period were greater. An asterisk ("*") with a "P" or "S" indicates whether average weekly shipments or variance of weekly shipments during the prorate or prorate suspension period, respectively, were significantly greater at the 5-percent level.

○